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Agenda For Municipal Revenue Reform; Sub
mission to the Alberta Task Force 1



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AGENDA FOR MUNICIPAL REVENUE

REFORM

by

VLADIMIR SALYZYN

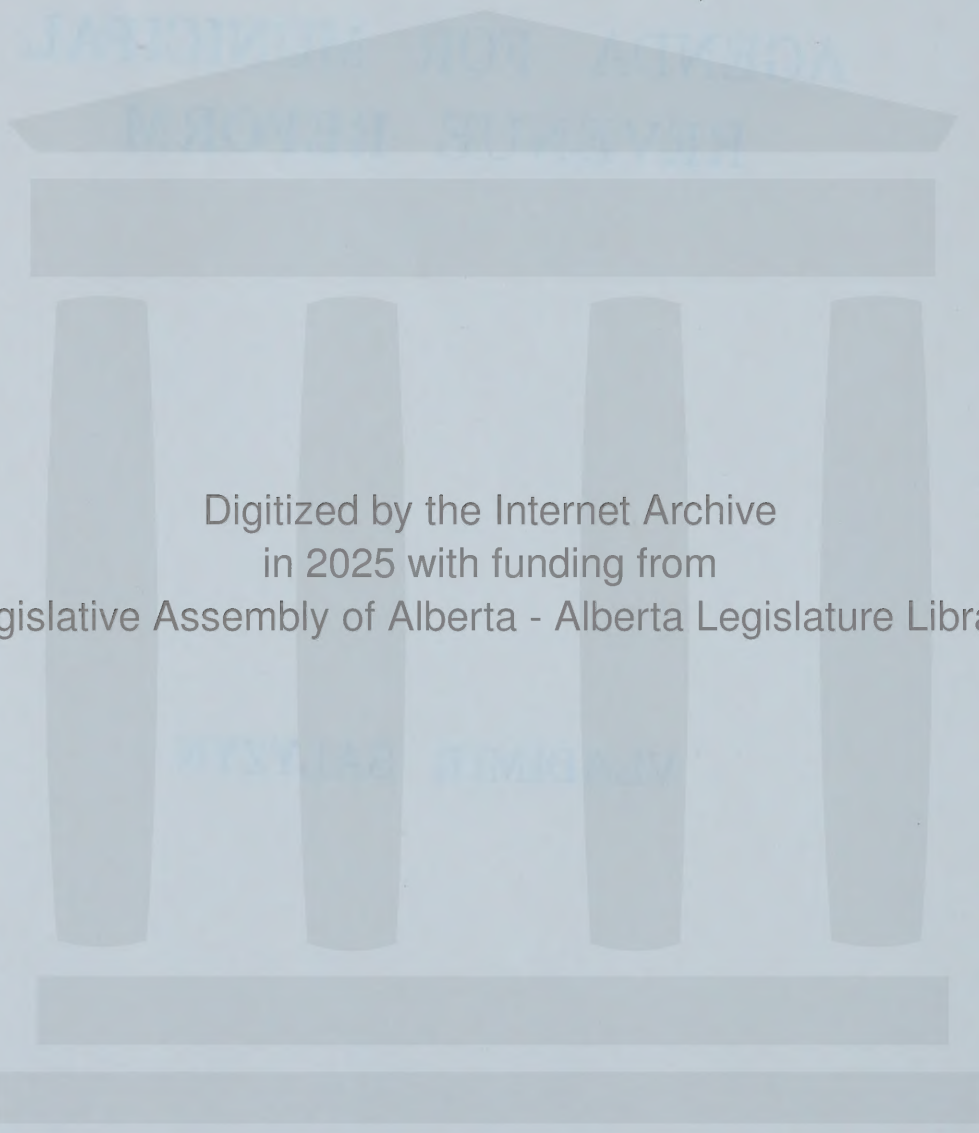
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AGENDA FOR MUNICIPAL REVENUE REFORM

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AGENDA FOR MUNICIPAL

REVENUE REFORM

A Submission to

M.L.A. Task Force on Provincial-Municipal Financing
Government of Alberta

by

Vladimir Salyzyn, B.A., B. Comm., M.A., Ph.D.

PREFACE

Concern over the fiscal plight of municipal governments in Alberta is almost always expressed in the form of dissatisfaction with the property tax. For some, this simply means that the government is spending too much; for others, it means that the government is spending its revenues inefficiently; for still others, the concern is with the nature of the property tax, the availability of alternative revenues, and the types of services that should be financed by local funds. It is my belief that it is the last of these that concerns most taxpayers in Alberta.

Although the immediate purpose of this submission is to recommend some alternative approaches to solving the fiscal problems of municipalities in Alberta, I was guided by much broader principles. As a result, my submission is disposed to deal more with general long-run solutions than with presenting a blueprint for immediate action. This is designed to differentiate basic revisions from patchwork solutions.

It is also my belief that your Task Force can fail to achieve its objectives equally from a misunderstanding of the underlying problems and causes as from a misspecification of the solutions. Consequently, emphasis is placed on a careful analysis of the sources of the problems. This procedure ensures that general guidelines precede detailed policy recommendations.

This submission is the first part of a two-part presentation. Solutions to the fiscal problems of municipalities can be placed into one of two categories: those that aid the municipal governments in discharging their responsibilities on their own, and those that involve some form of inter-relationship with the provincial government. The former includes improvements in existing revenue structures and the development of new forms of locally imposed and administered revenue sources. The latter consists of special provincial-municipal tax sharing arrangements and the re-allocation of revenue and expenditure responsibilities between the two levels of government. These latter solutions are not discussed in this submission, but are examined thoroughly in a companion submission, Agenda for Provincial-Municipal Fiscal Reform.

Chapter IV was written jointly with Bernd Ebel and Chapter V includes material first appearing in Municipal Finance.

An extensive bibliography is attached to each of the four chapters dealing with new revenue sources. This is intended to facilitate further study where necessary.

Vladimir Salyzyn

Edmonton, Alberta, 1972

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CHAPTER I THE PROBLEMS, CAUSES AND SOLUTIONS

Introduction

Ten years ago the premier of the Province of Alberta made a policy statement that proposed "a factual study" of how public expenditures can be best "financed having regard to the legitimate needs and best interests of the people of the province as a whole". A committee of representatives was drawn from a number of important provincial organizations and from the provincial government to perform this task. In 1966, the results of their deliberations were made public in a study entitled Report of the Public Expenditure and Revenue Study Committee.

This Committee failed to achieve its goal for several reasons, but primarily because it served mostly as an apology for existing policies. The Committee lacked proper detachment and was unqualified to perform intensive expert analysis. Nor was any attempt made by the Committee to develop any cohesive scheme in line with generally accepted fiscal principles.

The patchwork solutions recommended by the Public Expenditure and Revenue Study Committee only served to postpone serious study, while dissatisfaction with the fiscal situation continued unabated. Municipal representatives almost immediately called for rational resolution of their pressing

revenue problems.¹ The government also resumed the investigation of both the property tax and the problems of financing education.² Unfortunately, the government again used committees much the same in structure as the Public Expenditure and Revenue Committee.

Finally, in 1971, the provincial government recognized the need for an independent, comprehensive investigation, and appointed a three-man Royal Commission. This Commission was immediately abandoned by the new Conservative government and a legislative task force was substituted in its place.

This legislative task force may be less attached to existing practices and past policies than the previous committees were, nevertheless, this task force will be seriously hampered in its work unless it takes the effort to develop sound principles and endeavours to work independently of outside pressures.

Great care must be exercised not to commit the errors made by the Public Expenditure and Revenue Committee. The Committee complained that despite "large transfer payments" and "the assumption of about 45 per cent of the cost of elementary and secondary education", and "the assumption ... of

¹Urban Crisis, Alberta Municipal Finance Study (Calgary: Cities of Alberta, Alberta Urban Municipalities Association and Public and Separate School Boards in Each City, 1968).

²Minister's Committee on School Finance, Report of the Minister's Committee on School Finance, (Edmonton: Department of Education, Government of Alberta, 1969). Report of the Special Committee Appointed by the Government of Alberta to Study Assessment and Taxation, (Edmonton, 1970).

a very high proportion of the costs of welfare, public health and hospitalization services", the municipalities "are not able to discharge their responsibilities" without difficulty. And yet the Committee recommended more of the same types of transfers of funds.³ As explained below, this kind of solution has in fact become the problem.

The only principle that appeared in the Committee's report was "that responsibility for service should be determined by the criterion of which level of government can best perform the service".⁴ Since this principle has nothing to say about which level of government is held responsible for policy decisions, it has simply ignored the main source of the problem.

The Problems

Since it is a common pitfall to assume that municipal fiscal problems are obvious and that one need only direct effort to seeking solutions, great care is taken here to identify the problems carefully and accurately.

A complete list of the more important provincial-municipal fiscal problems can be identified as belonging to one or more of the following general categories.

1) Responsibility Imbalance. The level of government that raises the revenues does not always have a corresponding part

³Province of Alberta, Report of the Public Expenditure and Revenue Study Committee, (Edmonton, 1966), p. 114.

⁴Ibid., p. 114.

to play in the decision on how the money is spent. Alternatively, the level of government that spends the money may have no say on how the revenue is raised. Misallocation of resources results whenever responsibilities for expenditures are not matched by responsibilities to raise revenues for them. This problem arises whenever a junior level of government depends on financing from the senior level, and leads to the undermining of "accountability, cost control and normal priority-setting processes".⁵

2) Capacity-Obligation Imbalance. Revenues available at the local level are insufficient to provide for the expenditures expected to be undertaken at this level because revenues sources are inadequate and/or because expenditure obligations are excessive. The first of these is caused by a responsibility imbalance (number 1 above) or by fiscal inefficiency (number 4 below) or both. The second is often the consequence of a benefit-cost imbalance (number 3 below).

3) Benefit-Cost Imbalance. There exist spillovers of benefits and costs between the province and its municipalities and among the municipalities. For example, local governments are often called upon to supply public goods and services that yield benefits to those located outside their jurisdiction. In like manner, certain municipalities may create additional costs to

⁵From a statement by a Provincial Treasurer at the 1972 finance ministers meeting in Jasper, Alberta.

those in other areas.

4) Fiscal Inefficiency. Fiscal inefficiency manifests itself most clearly in the inadequate design of local revenue structures. Inefficiency also arises from a lack of tax coordination among municipalities and the province. This latter type of fiscal inefficiency can aggravate the capacity-obligation imbalance (number 2 above) and contribute directly to a responsibility imbalance (number 1 above).

5) Horizontal Inequality. Differences in fiscal capacity among municipalities accentuate most of the other provincial-municipal fiscal problems, particularly for those governments with the lowest capacity to discharge their obligations. Fiscal capacity must be distinguished from fiscal performance which may lag behind capacity for a variety of reasons.

Some Solutions

A number of solutions to intergovernmental fiscal problems have been suggested recently by several world renown experts. Joseph A. Pechman of the prestigious Brookings Institution, for example, suggests: expansion of the local tax base by improving the property tax and adding sales and income taxes; increasing grants-in-aid; shifting welfare costs to higher levels of government; providing credits for taxes paid at the local level; increasing tax coordination between levels of government; and supplements from the federal government

during periods of unemployment.⁶ To this list, Bernard P. Herber, a professor of economics, adds a negative income tax as a means of solving poverty problems at the local level.⁷ Donald G. Alexander, Legislative Counsel to the National League of Cities, suggests the assumption of all local costs of welfare, education and pollution control by higher levels of government. Alexander would also like to see the consolidation of local governments and more reliance being placed on the private sector.⁸

This list may not be comprehensive enough for provincial-municipal fiscal problems in Alberta, but it offers a rather encouraging number of possible alternatives.⁹ The only danger with such an extensive list is that it provides zealots an avenue for their own pet solutions, making rational choice difficult.¹⁰

⁶Pechman, J.A., "Fiscal Federalism for the 1970's", National Tax Journal, September 1971.

⁷Herber, B.P., "Discussion", National Tax Journal, September, 1971.

⁸Alexander, D.G., "New Directions in Urban Financing", Annual Editions Readings in Economics '72, (Guilford: Dushkin, 1972).

⁹Another solution that can be added to the list is the changing of the BNA Act to re-assign responsibilities between the levels of government. See V. Salyzyn, "How Efficient Constitutional Re-allocation of Governmental Financing Can Help Canada Solve Pressing Urban Problems", Civic Administration, October 1970.

¹⁰One need only follow the local press to get evidence of this.

The following are the most logical solutions

(see Table 1-1):

- 1) Responsibility imbalance can be corrected by minimizing the role assigned to inter-governmental grants (since these are the prime source of the problem), by improving existing municipal revenue structures and by coordinating tax revenues with the province.
- 2) Capacity-obligation imbalances can be solved by correcting responsibility imbalances and removing the benefit-cost imbalance.
- 3) The benefit-cost imbalance, in turn, can be solved only by re-assigning legal responsibilities between the province and the municipalities.
- 4) Fiscal inefficiency can be reduced by improving current revenue sources, by introducing new sources and by rationalizing inter-governmental tax relations.
- 5) Although horizontal fiscal inequality among municipalities can be solved by encouraging labour and capital migration through normal market processes, expenditure programs and grants-in-aid would be more acceptable on humanitarian and equity grounds. Grants-in-aid, however, must be limited only to those municipalities in need in order not to aggregate responsibility imbalances.

TABLE 1-1 PROVINCIAL-MUNICIPAL PROBLEMS, CAUSES AND SOLUTIONS

<u>Problems</u>	<u>Main Causes</u>	<u>Principle Solutions</u>
I. Responsibility imbalance	1. Grants to municipalities 2. Inefficiency (Problem IV)	a. Improve revenue structures b. Minimize use of grants c. Coordinate taxes with province
II. Capacity-obligation imbalance	2. Inefficiency (Problem IV) 3. Benefit-cost imbalance (Problem III) 4. Responsibility imbalance (Problem I)	a. Improve revenue structures b. Minimize use of grants c. Coordinate taxes with province d. Correct misallocation of responsibility among levels of government
III. Benefit-cost imbalance	5. Misallocation of responsibility among levels of government	d. Correct misallocation of responsibility among levels of government
IV. Fiscal inefficiency	6. Inadequate local revenue structure 7. Poor tax coordination with province 8. Regional economic disparities	a. Improve revenue structures c. Coordinate taxes with province e. Grants-in-aid (conflicts with solution b)
V. Horizontal inequality		f. Regional expenditure programs

The list of principle solutions is as follows
(see Table 1-1):

- a. Improve municipal revenue structures.
- b. Minimize use of grants.
- c. Coordinate taxes with province.
- d. Correct misallocation of responsibility among levels of government.
- e. Grants-in-aid (conflicts with solution b).
- f. Regional expenditure programs.

Solution a, the improvement of municipal revenue structures, is discussed in the remaining chapters of this submission. Chapter II undertakes a projection of municipal revenues and Chapter III evaluates the general principles underlying the distribution of property tax burdens. Chapter IV evaluates the feasibility of increasing the use of service charges as a source of municipal revenues. The next three chapters discuss the feasibility of three new forms of purely local taxes: the municipal income tax, the municipal sales tax and the municipal value-added tax. The final chapter, Chapter VIII, presents some recommendations.

The discussion of solutions b to e is deferred to the companion submission, Agenda for Provincial-Municipal Fiscal Reform. Solution f, regional expenditure program, is beyond the scope of either of these submissions.

CHAPTER II A PROJECTION OF MUNICIPAL REVENUES

Introduction

A projection of municipal revenues would serve the purpose of identifying potential shifts in the types of problems that might be encountered in the future. For example, a projection that showed increased reliance on grants to municipalities would indicate a widening of the responsibility imbalance and add to the capacity-obligation imbalance, and increased dependence on the current property tax would perpetuate fiscal inefficiency. Such projections would also reveal whether new sources of revenue were needed. Since different municipalities have different fiscal problems, projections would have to be made for each municipality separately. Aggregate projections would only serve to hide most of the potential problems.

Comparisons of revenues and expenditures among municipalities would be useful in identifying the problem of horizontal inequality, and projections would reveal the extent to which these inequalities are likely to continue. Since this study does not pursue this particular problem further, such comparisons and projections are not made here.

Expenditure patterns would also have to be studied in order to locate misallocations of responsibilities between the province and the municipalities. This issue is postponed

to the companion study, Agenda for Provincial-Municipal Fiscal Reform. For these reasons, only revenues are projected for only one municipality.

A projection of the revenues of the City of Edmonton is undertaken here as an illustration of the types of issues and procedures involved in predicting municipal tax revenue needs.

The fiscal position of the City of Edmonton during the period 1961-70 is used as the base for making the projections of revenues for the year 1981. The revenue structure is assumed to remain unchanged during the next ten years.

Sophisticated and highly refined techniques for making revenue projections have been developed in recent years. Most of these approaches use intensive analysis of underlying economic indicators. Statistical techniques using multiple correlation analysis are fed data on such things as disposable personal income, prices, employment, business investment, housing trends, business cycles, population characteristics, tax rates in other cities and a host of other items. All of these factors no doubt, have significant effects on the development of the revenue structure, but projections based on such techniques are best suited for short term budgetary purposes. The detailed assumptions and numerous predictions required would unduly strain the analysis if these had to be projected up to the year 1981. The best approach for making medium and long term projections

is to related past performance to a limited number of the simplest and most generalized economic and demographic variables available.¹

The projections made here are based primarily on the revenue experience during the past and the relationship of the various sources to the level of total personal income and to the size of the population of the City of Edmonton. Personal income and population are chosen because they are closely related to city revenues and are relatively simple to measure and easy to predict.

Ultimately, all city revenues must come from income. As income rises so does the ability of the city to raise revenues. Consequently, many revenues are directly related to levels of personal income. Other revenue sources, however, may be more closely associated with the number of people that contribute to revenues. The total population and personal income estimated for the City of Edmonton for the year 1981 are 570,000 and \$3.3 billion respectively.²

Some revenues, however, are not sufficiently related directly to either the population or the level of personal income. The property tax is an example of this. This tax is subject to frequent rate and assessment adjustments.

¹This type of approach was successfully used by the Graduate School of Public Administration of New York University in its study, Financing Government in New York City, New York, 1966.

²Based on E.J. Hanson, The Unification of the Edmonton Metropolitan Area - A Fiscal Study, (Edmonton, 1953).

Furthermore, because the property tax functions as a residual source of municipal funds, revenue from it will not be explicitly projected here. It will be assumed, along with general practice, that property tax revenues are used to fill in the gap between total expenditures and all other sources of revenue. Local improvement taxes, business taxes and sewer frontage and service charges are less subject to immediate rate and assessment adjustments than the property tax, but in the long-run they are closely tied to the property tax.

Revenues that are predictably related to either population or personal income are grouped into these categories and converted to per capita revenues and to revenues per \$1,000 of personal income respectively. Projections of trends of past performance are then made of these averages by a variation of the straight line least squares method.³

Projection of Non-Tax Revenues Related to Population

Several revenue items of the City of Edmonton were closely related to population during the past several years. Although there were some individual variations, the aggregate of the following revenue categories showed a relatively consistent and unmistakeable relationship to changes in population:

³The least squares method assures the best fitting straight line to a series of points on a graph by accomplishing two results. First, the sum of all vertical deviations of the points from the straight line is equal to zero. Secondly, the sum of the squares of all these deviations are at the minimum. This second result automatically assures the first. This approach assumes that deviations in any year from the straight line arise merely by chance and that a long-run trend does in fact exist. The least squares method simply identifies this trend accurately.

1. Licenses and Permits
2. Fines
3. Interest Earnings
4. Service Charges

The more people there are the more licenses and permits of all sorts that will be applied for. Also, more people means more fines and more tax penalties to be paid (tax penalties are a major component of the Interest Earnings category). Most service charges levied by the City of Edmonton are directly related to individual demands and increase with population.

Total revenues from these four sources are projected to yield \$11.4 million in 1981.

Projection of Revenues Related to Income

The revenues that have shown a close and consistent correlation with the level of personal income during the past are the following:

1. Rents, Concessions and Franchises
2. Recreation and Community Services
3. Welfare Cost Recovery
4. Health Services Revenues
5. Municipal Assistance Fund
6. Grants in Lieu of Taxes

Revenues obtained from other governments in the form of grants and payments in lieu of taxes normally are subject to discretionary changes, but the policy in the past

indicates that Edmonton's share of such funds increased directly with personal income.

Revenues from these items, ranged from \$11.08 to \$12.47 per \$1,000 of personal income and averaged \$11.95 in the past. The yield in 1981 should be \$12.00 producing \$39.6 million in revenue.

All other non-tax revenues, except those from city owned enterprises, are assumed to remain at approximately 1.5 per cent of total revenues. By 1981 these revenues are projected to equal \$3.2 million.

Projection of Revenues From City Owned Enterprises

There are six city-owned utilities involved in producing revenues for the city. These are:

1. Edmonton Power
2. / Edmonton Transit
3. Edmonton Telephones
4. Edmonton Water
5. Edmonton Industrial Airport
6. Edmonton Generation

Edmonton Generation is combined with Edmonton Power for projection purposes.

These utilities produce revenue in four separate ways:

1. A municipal tax levy is paid by all five utilities.
2. A gas franchise is paid by Edmonton Power.

3. Revenue taxes are currently received from all except the transit system and the airport. The transit system paid the tax until 1961.
4. Net profits are allocated to the general revenues of the city.

The municipal tax levy is treated together with the general municipal tax category as a residual, and the gas franchise was part of the revenues already projected in this section. These two items are projected separately. One of the reasons for separate projection of the revenue tax is that the tax is based directly on gross revenues which can be projected simply and entirely apart from profits. The projection of profits is a great deal more complex task and requires special treatment.

Gross revenues, and consequently tax revenues based on them, are projected separately for each of Edmonton Telephones, Edmonton Water and Edmonton Power. Gross revenues per capita are used as the basis for the projections. Separate population figures are used for the three respective projections because they service different areas. For Edmonton Telephones the estimated number of people within the exchange boundaries in 1981 is estimated at 506,000. The estimated 1981 population within the power distribution boundaries is 574,000.

Edmonton Water supplies water to customers outside the corporate limits of the City of Edmonton. As an alternative to estimating the population serviced in these adjacent areas, the revenue received by Edmonton Water from these sources

is deducted from total revenue based only on the population within the corporate boundaries of Edmonton. This estimate of per capita revenue is then applied to the entire area. This probably creates less distortion than would arise if the population serviced beyond city boundaries had to be estimated and used to calculate per capita revenues in this much larger and geographically complex area.

As could be expected, per capita gross revenue increased in all three instances, most rapidly for Edmonton Telephones and least rapidly for Edmonton Water. Increases in the per capita gross revenue of Edmonton Telephones reflected primarily the increased number of telephones per person and the use of new and specialized equipment. The gross revenues per capita received by the Edmonton Water increased much less spectacularly because the use of water per person is not likely to rise very rapidly once most basic demands have been met. A higher standard of living is much more likely to be reflected by an extension telephone than by more frequent baths or lawn sprinklings. The increased use of electrical equipment, both domestically and industrially, raised per capita gross revenue for Edmonton Power substantially. In each of these three cases the per capita gross revenue showed a remarkably consistent and predictable trend.

Edmonton Telephones is projected to yield gross revenues of \$66.13 per capita in 1981 producing \$1.7 million in revenue taxes. The comparable figures projected for Edmonton Water and Edmonton Power are \$19.00 and \$0.6 million,

and \$115.00 and \$3.3 million respectively. Total revenues from the tax are projected to equal \$5.5 million in 1981. These projections are based on the following assumptions:

1. The average increase in per capita gross revenues in the past will continue until 1981. This increase was estimated at \$2.03 per capita per year for Edmonton Telephones, \$0.22 for the Edmonton Water (for water distribution within the city boundaries only), and \$2.74 for Edmonton Power.
2. The gross revenues from the sale of water outside the city boundaries will grow at the same rate as gross revenues from the distribution of water within the corporate limits of the City of Edmonton.
3. The population within the telephone exchange boundaries will grow at the same rate as that within the corporate limits of the City of Edmonton and the exchange boundaries will remain the same during the entire period to 1981.
4. Power distribution will expand only to boundaries currently agreed to. The population within the power boundaries will increase at the rate projected for the City of Edmonton.
5. The revenue tax will remain at the current rate.

Now the profit contributions of the utilities will be projected. Separate projections of each utility's contribution to general revenues could be made. This was not done, however, because such an approach yields no net advantage so long as the contributions to city revenues can be readily projected in the aggregate. Furthermore, the operations of utilities are sufficiently complex to swamp the analysis with too many details, which, although useful in understanding the performance of these enterprises, could in many cases become progressively unmanageable for revenue projections beyond normal budgetary horizons. The aggregate approach has the added advantage of incorporating overall financial policy that may be implicitly operative over time. However, it is useful to separate the utilities into at least those that consistently add to general revenues and those that are continually subsidized by the City. As a result, the utilities that pay the revenue tax are treated as a unit separate from the Edmonton Industrial Airport and Edmonton Transit which are normally subsidized by general revenues.

Even aggregation of the profit-yielding utilities poses some serious problems for the projections. Utility profits are dependent on many variables not only difficult to predict but often not easy to recognize, such as technological innovations, shifts in demand, and changes in pricing policies. The contribution of utility profits to city revenues have shown no readily recognizable pattern during the past other

than a general upward trend. However, through the combination of physical operations and the accounting and pricing policies followed during the past, total profits from operations (as distinct from profits allocated to general revenues) have been kept at a relatively predictable average proportion of gross revenues. Since gross revenues have already been projected above, the projection of total profits are readily available. It only remains to establish the relationship between total profits and the amount of these profits allocated to general revenues. This is the area in which deliberate policy decisions are very important. An unmistakeable trend seems to have established during the past several years toward eventually allocating the entire amount of earned profits to general revenues. If this in fact comes about, the projection of total profits can be substituted for the projection of profits allocated to general revenues. Following this procedure profits allocated to general revenues are projected to reach \$27.1 million by 1981. This means that when the proceeds from the revenue tax are added to this amount the total addition to general revenues are projected to be 32.6 million in 1981.

Subtracted from this amount will be the projected losses sustained by the other two utilities. Since airport losses have virtually disappeared and are an insignificant amount in any case, it is assumed that the operation of the Edmonton Industrial Airport will produce no net losses or surplus in 1981.

The projection of the financial position of Edmonton Transit is very complex. Involved are numerous factors associated with the level of demand and service, technology, innovations, pricing policies and community initiative. It appears that deficits are bound to continue and by 1981, the deficit is projected to be over \$2.8 million.

Non-tax revenues in total are projected to yield 83.8 million in 1981. By 1981 projected expenditures of the City of Edmonton should reach \$215 million.⁴ This leaves a gap of \$131.2 million to be filled by the property tax and related charges (local improvement taxes, sewer frontage and service charges, and business taxes).

Projections for the Hanson Area⁵

City boundaries do not remain unchanged and different boundaries mean different revenue problems. This section makes projections based on the boundaries recommended by Hanson.

The projection on non-tax revenues for the Hanson Area is based directly on the procedure developed in the projection of revenues for the corporate limits of the City of Edmonton. The implicit assumptions are the following:

1. The Hanson Area will have the same tax and revenue structure as the City of Edmonton.

⁴Expenditures are projected at the same rate of growth as those projected by E.J. Hanson in The Unification of the Edmonton Metropolitan Area - A Fiscal Study, (Edmonton, 1968).

⁵The area recommended for City of Edmonton boundaries by E.J. Hanson, ibid.

Whether this is realistic for the next few years depends upon the length of the phasing-in period for standardizing the revenues for the entire area. How realistic this assumption is for the more distant future depends on whether the current sources of revenue will experience any structural changes by 1981. Predictions of neither of these two events are within the scope of this submission.

2. The relationships between population and revenues based on population will remain the same whether population increases because of greater density within the corporate boundaries of the City of Edmonton or because of increased population arising from extended boundaries. This means, for example, that revenues from licenses, permits, fines, interest earnings and service charges will increase directly with additions to population regardless of the source of these additions.
3. The relationships between personal income and revenues based on income remain the same regardless of the geographic sources of this income. This applies to both the corporate boundaries of the City of Edmonton and the larger Hanson Area.

In accordance with these assumptions and the techniques employed in projecting revenues for the City of Edmonton, the projected non-tax revenues exclusive of utilities can be expected to take the following pattern for 1981, measured in millions of dollars:

Income based revenues	\$43.7
Population based revenues	13.8
Other Non-tax revenues	3.6
Total	<u>\$61.1</u>

Utility revenues can be projected on the basis of several alternative conditions regarding the scope of the services to be offered. An estimate is made based on the following assumed conditions for each of the utilities:

1. Edmonton Power. Power boundaries as extended under current agreements will be the boundaries in existence for the remainder of the projection period. Population within this area will serve as the basis of the projection.
2. Edmonton Telephones. Current exchange boundaries will continue until 1981.
3. Edmonton Water. Since current water sales outside the corporate limits of the City of Edmonton include most of the major water users within the Hanson Area, it is assumed that no additional water will be supplied beyond expected increases over time. It is assumed that the increase in rates from wholesale to retail will increase gross revenues but not profits.

4. Edmonton Industrial Airport. It is assumed that the Airport revenue position will not be affected by the annexation of the Hanson Area.
5. Edmonton Transit. Larger deficits are most likely to arise as the service is extended to include outlying areas.

Under the foregoing assumptions the projections for the City of Edmonton need to be adjusted to arrive at projections for the Hanson Area only in the following ways:

1. The deficits of the Edmonton Transit System need to be projected for the larger area.
2. Water rates for the area outside current corporate boundaries will have to be adjusted from wholesale to retail levels to estimate the increase in gross revenue to arrive at additional revenue tax receipts.

It is extremely difficult to judge the extent of any increases in operating deficits that would result from the Edmonton Transit System extending its services to such places as St. Albert, Sherwood Park, the military bases, Oliver and other areas. Hanson estimated that the deficit would increase by about \$400,000 immediately upon the implementation of such services on the basis of 1966 operations. On this basis the deficit for the Hanson Area would reach \$3.2 million by 1981.

The average revenue per cubic foot received from the wholesale of water to areas adjacent to Edmonton amounts to only 81 per cent of the average gross revenue per cubic foot obtained from water sold within the City of Edmonton. The higher gross revenues per cubic foot received by Edmonton Water within the City of Edmonton is explained by the fact that these revenues include the water frontage tax and other miscellaneous earnings in addition to the retail rates charged for the water actually consumed. These additional revenue sources would be available to the City of Edmonton if the expansion area was added to the City. On this basis additional gross revenues from Edmonton Water would amount to \$135 thousand in 1981 yielding \$7 thousand in revenue taxes. This amount is too small to affect the projections of total revenues.

The non-tax sources of revenue and tax revenue requirements projected for the Hanson Area show that approximately \$158.5 million of property tax and related revenues will be required by 1981. If any of the non-tax revenues should fall short of projections, the burden placed on the poverty tax will be even greater than estimated here unless alternative new sources of revenue are developed.

Prospects for the Property Tax

The role of the property tax should continue to decline as a source of revenue even if no change is made in municipal revenue structures. Table 2-1 indicates that by

TABLE 2-1 SELECTED REVENUES OF THE CITY OF EDMONTON AS A
PER CENT OF TOTAL REVENUES, 1961-81

Year	Population		Income		City		Property and Related ³ Taxes
	Related Revenues ¹		Related Revenues ²		Enterprise		
1961	5.8		13.7		11.4		68.2
1962	5.6		13.8		11.5		68.2
1963	5.3		13.8		13.1		67.7
1964	5.6		13.7		13.5		63.5
1965	5.2		14.3		14.5		65.6
1966	5.5		15.8		14.9		63.4
1967	5.3		16.2		13.9		62.9
1968	5.3		16.1		13.6		63.3
1969	5.9		16.7		12.1		63.6
1970							
1981	5.3		18.4		13.9		64.8

¹Licenses, Permits, Fines, Interest Earnings and Service Charges.

²Rents, Concessions, Franchises, Municipal Assistance Fund, Grants in Lieu of Taxes, Welfare Cost Recovery, Health, and Recreation and Community Services.

³Local improvement taxes, sewer frontage and service charges, and business taxes.

1981 property and related taxes will be called upon to raise approximately 65 per cent of Edmonton's total revenues. This is about what these taxes consistently produced over the years.

By 1981, property and related taxes should reach a level of about \$230 per capita in Edmonton (see Table 2-2). This is more than double the amount collected per capita in 1961. However, the expected per capita percentage increase is less than that expected of the other revenue sources related to population growth.

Much more revealing is the amounts of revenue collected per \$1,000 of personal income. Property taxes have declined as a per cent of income during the past decade and are expected to decline even further. The capacity of Edmonton taxpayers to pay taxes is increasing more rapidly than tax collections.

One of the reasons that the overall burden of the property tax has been declining is the gradual removal of the tax as a source of funds for financing education. In 1970, for example, of the \$343 million spent on elementary and secondary education in Alberta only \$135 million or 39 per cent came from the property tax.⁶ The relationship between education and the property tax in Edmonton is presented in Table 2-3. The per cent of property taxes collected in Edmonton that is allocated to school finance has remained almost unchanged for more than a decade.

⁶Canadian Tax Foundation, Provincial and Municipal Finances, 1971, (Toronto: Canadian Tax Foundation, 1971), p. 159.

TABLE 2-2 THE RELATIONSHIP OF SELECTED REVENUES OF THE CITY OF EDMONTON
TO POPULATION AND PERSONAL INCOME, 1961-1981

Year	Per Capita			Per \$1,000 Personal Income		
	Population		Property and Related ³ Taxes	Income		Property and Related ³ Taxes
	Related Revenues ¹			Related Revenues ²		
1961	\$ 8.92		\$106	\$12.37		\$61
1962	9.18		112	12.13		60
1963	9.01		114	12.17		60
1964	9.49		107	11.39		53
1965	8.93		112	11.08		51
1966	9.84		115	11.56		47
1967	10.35		123	11.98		47
1968	11.73		127	12.41		49
1969	14.00		152	12.47		47
1970						
1981	20.00		230	12.00		40

See Table 2-1 for notes to the table.

TABLE 2-3 EDUCATION AND THE PROPERTY TAX
IN EDMONTON, 1958-1971

<u>Year</u>	<u>Per Cent of Edmonton Property Tax Allocated to School Finance</u>	<u>Per Cent of School Cost Paid by Edmonton Property Tax</u>
1958	62	68
1959	62	67
1960	61	66
1961	61	62
1962	60	63
1963	63	63
1964	62	54
1965	66	53
1966	64	45
1967	65	42
1968	69	47
1969	68	47
1970	65	
1971	64	

Taxpayers in the rest of Alberta also have adequate capacity to pay the property tax. Growth in personal income has been more than sufficient to provide for the growth in property tax requirements.

To reveal that there is adequate capacity to pay the property tax is not to endorse its continued use in the present form. Not only should the property tax be further reduced as a source of funds to finance education, a portion of it could be replaced by other forms of revenue. Furthermore, regardless of the amount of revenue raised by the property tax, it could be easily improved, particularly in the way it's burden is allocated among the taxpayers.

These and other issues are examined in depth in the remaining chapters.

CHAPTER III PROPERTY TAX BURDENS

Introduction

The property tax has been used as a source of local revenues for a very long time and will continue to play a vital role in the foreseeable future even if new sources of municipal revenues are developed. The property tax has been the centre of continuous controversy plagued with an astounding amount of misunderstanding, particularly concerning the questions of who should pay the tax and who in fact does pay it. No meaningful reform of the property tax can be undertaken without an ample grasp of the significance of the concept of tax burdens.

A conceptual framework for communication and for the recognition of the complexity of the property tax is indispensable to its proper assessment. Piecemeal adjustments to the tax without comprehensive guidelines can only perpetuate the current inadequacy of the property tax. The prime source of the problem is the popularly accepted view of taxation based on the fallacies that (1) property, in itself, has the capacity to bear a burden, and that (2) legal tax liabilities measure actual tax burdens.

A proper assessment of these views requires some general consensus or agreement on the meaning to be attached to the concept of a tax burden. However, regardless of the school of thought one subscribes to, everybody would concede

that tax payments are always manifested in some type of loss, sacrifice, reduction or similar consequence ultimately attributable to something possessed or aspired to by some individual. In other words, all taxes invariably decrease the welfare of some person by reducing either his wealth, income or the consumption of goods and services he enjoys. There is simply no way in which a government can find a method of collecting tax funds that are not accompanied by such or similar reductions of somebody's personal welfare.

Since each portion of the tax is ultimately vested with some individual, it follows that the burden of a tax can rest only with people and never with things. Things can, at best, only serve as a measure of this burden. However, this is not generally the view accepted in popular attitudes towards the property tax. Much too often society is bombarded with comments such as "let business pay more of the property tax", or "why does church property not contribute its fair tax share", with a fully literal interpretation attached to these observations. And yet, if we trace the consequences of levying taxes on business or church property, we are led directly and unmistakably to the conclusion that it is the shareholders, consumers, employees, and/or some other persons who must have actually paid the tax through a reduction in their economic welfare.

Any change in the property itself caused by the imposition of the tax is simply an additional measure of the

tax burden associated with the ultimate personal rights attached to the specific property.

The recognition that only people have the capacity to pay taxes is not enough. Those concerned with tax equity must still identify the actual person or persons who bear the burden. But, again, a common fallacy intervenes. The legal transfer of tax funds is popularly considered to provide all the evidence necessary for identifying those individuals who are the actual bearers of the burden. Unfortunately, things are not so simple, and the identification of the ultimate bearers of the tax burden is a highly technical problem that goes far beyond the mere payment of money to the government. Property tax burdens are allocated through a complex process of tax shifting that often alters the incidence of the legal payment beyond all recognition.

Tax shifting takes place in the market place through the mechanism of supply and demand for goods and services and is measured by changes in prices and quantities. The amounts that prices and quantities change depend on several factors among which are: the market structure (measured by the degree of monopoly power), the cost of production at various levels of output, the responsiveness of demand to price changes (elasticity of demand), the location of the property, the length of time involved, and the personal decisions concerning work effort, saving behaviour and the propensities to purchase goods and services.

Measuring Tax Burdens

Measuring the final tax burden is a very complex and difficult task and can be achieved only with limited precision even by experts. However, there are certain logical steps that can be taken in making a reasonably accurate estimate of the ultimate burden of the property tax.

The first step, of course, is to identify the source of the initial payment from which shifting adjustments can be traced systematically. Only a few of the more important and obvious market and behavioural adjustments involved in tax shifting will be presented in this chapter. This will serve more as an illustration than as a prescription.

First, property should be classified according to the type of specific shifting adjustments that are likely to occur when a tax is imposed on it. For this purpose, property may be divided into residential and non-residential; the residential could be further subdivided into rental and owner-occupied; the non-residential could be divided into business (industrial, commercial) and non-business (churches, schools). In addition, each of these classes of property have land and non-land components. Further refinements may be desirable.

Most experts on property tax burdens agree that residential property taxes are borne primarily by the occupants whether they are tenants or owners. Tenants bear the burden

in the form of higher rents passed on to them by the landlord. The actual amount of the tax shifted depends on the degree of influence exerted by the various factors enumerated above. In the long run, all of the tax tends to be borne by the tenants.

Because owner-occupants, as such, have no or little opportunity to raise the price of anything they sell (or lower the price of the things they purchase), they will normally be both the legal and actual bearers of the tax burden. No shifting is involved.

Non-residential business property taxes are likely to be paid by consumers, savers, wage earners, and/or profit earners in the form of higher prices or lower returns set by the market. Tracing the amounts actually borne by different individuals would require complete knowledge of the prices, wages, profits, interest rates, and quantities of goods and services involved.

There is general agreement that a non-residential non-business property tax such as the one that could be levied on church property would normally be borne entirely by the owners (members).

There are obviously many obstacles to tracing the entire burden of property taxes through price and output effects. No easy answer exists. However, meaningful and reasonably accurate estimates can be developed with a little effort.

Some knowledge of final tax burdens is indispensable to the proper achievement of equity. And the better the knowledge the greater is the probability that equity will be achieved. Unfortunately, even full knowledge concerning the actual allocation of property tax burdens among individuals still leaves the question of who should bear the burden unanswered. Which members of our society should have their economic welfare reduced by the property tax and in what way?

Who Should Pay the Property Tax

There are two well established equity guidelines for deciding who should pay the property tax. These guidelines are (1) the relationship between the individual's tax contribution and the governmental services he receives, and (2) the economic well-being of the taxpayer. The application of these guidelines to the property tax involves establishing, in the first case, the degree of correspondence between benefits received and payments made, and in the second case, the individual's ability to pay for the governmental services. The first of these attempts to relate property tax payments directly to the government expenditures involved, while the other deals with property tax payments entirely independent of the use of funds.

The benefit principle comes from the business sector of our economy where it is considered to be inherently "fair" that individuals should pay for the goods and services they

"buy" or receive. Although the evidence is not decisive, most experts agree that some portion of the property tax should definitely be based on this principle. Police and fire protection and certain public works are good examples of direct services rendered to property.

The ability-to-pay principle means that persons who possess equal economic well-being should make equal contributions to support governmental activities, and persons with greater economic well-being should make greater contributions. Many individuals also hold the view that ability to pay increases even more rapidly than economic well-being requiring progressive taxation.

Justification of property taxation on the ability-to-pay principle is greatly complicated. Some of the reason is that no universal consensus exists on what necessarily constitutes ability to pay. Three measures of economic well-being have been proposed at one time or another. These are: income, net wealth, and consumption expenditures.

Income is the amount a person obtains from his possessions or from everyday activities that can be used to buy goods and services or be saved for future use. Income can be measured by total consumption expenditures plus the net change in personal wealth. This is essentially the measure adopted by the Royal Commission on Taxation and is generally accepted as the best single criterion of a person's economic well-being; but it is wrong to assume that income is the only measure of ability to pay.

The mere possession of wealth or property also represents ability to pay. For example, equal incomes but different amounts of wealth for two persons would produce unequal economic well-being. The person with more wealth not only needs to save less from this current income to achieve the same security against future needs, but he can use a portion of his wealth to maintain a higher current level of living.

Economic well-being is also measured by the amount of goods and services consumed. Regardless of the amount of an individual's income or wealth, it can be claimed that the ultimate measure of well-being is the amount of goods and services he actually makes use of. Consumption indicates very simply and quite directly how well a person is living.

These three measures of economic well-being are not mutually exclusive. They are related to each other. Examples of some of the interdependencies are: income that is not spent generates greater wealth through savings; wealth can produce additional income; both income and wealth can be used for consumption expenditures; consumption is income minus savings; and saving increases wealth. Recognition of the inter-connection of income, wealth and consumption is vital to any judgement on who should pay property taxes.

How closely does the non-benefit portion of the property tax correspond to these three measures of ability to pay? Residential property taxes can be easily used as an

illustrative answer since such taxes are essentially borne by the tenants or by the owner-occupants, requiring no complex shifting assumptions.

Upon even causal observation a somewhat crude relationship seems to exist between a person's income and his property tax burden. However, this relationship is too erratic to fully support the ability-to-pay principle of equity based on income alone.

The property tax cannot be easily defended on ability to pay based on wealth either, particularly because property is assessed on the gross rather than net value. Furthermore, residential property constitutes only a fraction of total personal net wealth.

Because property tax burdens correspond quite closely to the value of the home or residential unit in which the taxpayer lives, it can be argued, as a reasonable first approximation, that property taxes can be justified by the ability-to-pay principle based on consumption, at least on that portion of consumption expenditure which is allocated to housing. But this is only a partial justification at best and it tends to discriminate against those who want to (or must) spend more of their income or wealth on providing a home for their family.

The portion of the residential property tax based on ability to pay must rest on the argument that it is partially related to each of the three measures of ability

to pay, and, in total, is not entirely inequitable. This is a somewhat uneasy case but not one that should be discarded off hand. The above observations should serve more as a challenge to reform than as an indictment of the property tax. And it should be remembered that the benefit portion of the property tax need not in any way be related to any of the measures of ability to pay.

As another simple illustration, the exemption of church property is used to highlight additional misunderstandings concerning the role of property taxation. To begin with, it can be assumed that taxes on church property are not shifted and borne entirely by church members. It can also be accepted as beyond argument that the benefit principle should apply to services rendered directly to church property.

How does the exemption of churches affect ability to pay? At first glance it is difficult to imagine how the ability to pay of church members is any different from that of non-members. As far as it is possible to ascertain there is no measurable difference in the incomes of church members as compared to non-members, except for the fact that poorer people may tend to accept church membership more readily.

What is the relative position of church members and non-members as far as net wealth is concerned? Again, there is no evidence of any differential.

There is also no measurable difference in total consumption expenditures between church members and non-members.

There is, however, a difference in consumption patterns. Church members, by definition, spend some of their income on providing and maintaining church facilities, while non-members spend more on other items. Since these other consumption items are not taxed, there is no justification for selecting churches for special taxation. The arbitrary inclusion of any expenditure item in the property tax base is bound to further increase the inequity of the tax. The argument for taxing churches under ability to pay based on consumption expenditure is no better than the argument for taxing yellow sports cars.

Rural-Urban Balance

This chapter will briefly touch on yet another current controversial issue--the School Foundation Program and relative rural-urban property tax contributions. A dangerously large amount of confusion exists in this area.

To begin with it should be clarified that the rural property tax and the urban property tax are two entirely separate forms of taxation as far as tax burdens are concerned and that the only logical comparison is between the total relative effects of these taxes and not between their separate parts. Farm owners are taxed primarily on the income-producing capacity of their property, while urban home-owners are taxed primarily on the level of their consumption expenditures on housing. The farm property tax is more like an income tax in its effect; land that can normally produce a higher income

will be usually assessed at a higher level. It makes no sense to insist that land should be assessed equally under both of these taxes because it is taxed for quite different reasons under these two separate types of taxes.

Thus, if the goal is to achieve fair and equitable relative contributions from rural and urban taxpayers, the only criteria to use are the ones enumerated above. Arguments related to exemptions or levels of assessment are in themselves completely irrelevant without explicit reference to the welfare of the individual taxpayers involved. For example, where would equity lie if a farmer's land was assessed only at half the rate of urban land and his house was completely exempt but his tax bill was greater while his income was lower! (Note: Total current property tax levies in rural areas in Alberta are a much higher per cent of income than in urban areas). Incidentally, equity would be seriously damaged if the farm property tax was changed in any way to correspond more closely to the less equitable urban property tax.

Several issues have been raised without attempts to develop complete arguments or offer specific recommendations because such an objective would have required a great deal of effort on the part of many individuals devoting their expert knowledge and research abilities over a much longer period of time. For this reason any discussion of the taxation of business property has been entirely omitted. The analysis

of business taxation is extremely complex in that it involves geographic tax shifting, seriously distorts efficiency in production, and is the source of several additional inequities besides being largely concealed from the ultimate tax bearer.

There is a strong need to break away from the influence of special interest groups and halt the perpetual propagandization of erroneous beliefs and attitudes popularly associated with the property tax. For example, it is plain nonsense to even mention "exemptions" or equalized assessment in any other context than as it relates to the economic well-being of ultimate taxpayers. Property in itself can neither pay taxes nor be exempt from them. An "exemption" available to a particular taxpayer imposes an unfair burden on other taxpayers only if the inclusion of the "exempt" item within the tax base could be justified as being fair to the taxpayers in the first instance.

The Distribution of Property Tax Burdens

Several studies of the distribution of Canadian property tax burdens by income levels have been made. The earliest estimate was made by Goffman, and another one was prepared for the Royal Commission on Taxation by Gillespie.¹

¹Goffman, I.J., The Burden of Canadian Taxation, (Toronto: Canadian Tax Foundation, 1962). Gillespie, W.I., The Incidence of Taxes and Public Expenditures in the Canadian Economy, Studies of the Royal Commission on Taxation, No. 2, (Ottawa: Queen's Printer, 1964).

The results of these two studies are summarized in Table 3-1.

Table 3-1. Property Taxes as a Per Cent of Income

<u>Income Level</u>	<u>Goffman</u>	<u>Gillespie</u>
\$ 0 - 1,000	6.9	} 16.3
1,000 - 2,000	4.7	
2,000 - 3,000	4.0	6.8
3,000 - 4,000	3.5	5.4
4,000 - 5,000	3.5	4.8
5,000 - 7,000	3.4	4.3
7,000 - 10,000	} 3.4	4.0
10,000 and over		3.8

At least two sources are available on the actual residential property tax payments made on owner-occupied dwellings in cities classified by income levels.² The results are given in Table 3-2.

Table 3-2. Property Tax Payments as Per Cent of Income

<u>Income Level</u>	<u>Calgary</u>	<u>Canadian Cities</u>
\$3,000 - 4,000	8.2	6.6
4,000 - 5,000	6.8	5.2
5,000 - 6,000	5.6	4.4
6,000 - 7,000	5.0	3.8
7,000 - 8,000	4.4	3.8

In interpreting the significance of these estimates it should be emphasized that the differences among income groups

²Urban Crisis, Alberta Municipal Finance Study, (Calgary, 1968), based on a survey made by the Planning Department of the City of Calgary. Urban Family Expenditures, Dominion Bureau of Statistics, (Ottawa), based on a survey of family expenditures in Canadian cities.

are much more than just differences in income. Variations in circumstances among individuals at the same level of income are often much more important than the fact that these individuals have the same income. For example, the lower income groups include: (1) retired people with substantial wealth and few fixed commitments, (2) high income individuals retired during the year with only part of their income recorded, (3) new entrants into the labour force with part of their average income being recorded and also with low costs of living (still living with parents), (4) businessmen, farmers, salesmen who are well-off on the average but had a bad year, and (5) high-income earners between jobs or temporarily disabled or ill.

A more meaningful classification of households that pay property taxes would include such things as: source of income, use of income, type and size of family, age of taxpayer, whether urban or rural, the amount of wealth, and so on. Unfortunately, estimates of the distribution of tax burdens along these lines are normally not undertaken because of the lack of adequate data; but without such studies there is simply no way of knowing whether the burden of the property tax is distributed fairly.

CHAPTER IV USER CHARGES*

Introduction

Whenever external economics in the form of community benefits are of little importance, it is possible for local governments to raise revenues by imposing a price for the provision of the service. If the individual benefiting from the service can be easily identified, he can be billed directly. Most public utilities operate on this principle.¹

The purpose of this chapter is to investigate the possibility of extending the benefit principle to the financing of the collection and disposal of refuse by means of service charges. The payment for refuse collection through the property tax completely distorts the relationship between benefits and contributions to the costs. Assessed property values are in no way related to the amount of refuse or the cost of removing it from the property.

The use of service or user charges to pay for refuse collection and disposal is not novel; it has been used successfully in other parts of Canada and in the United States for some time.² "While no panacea, badly-needed municipal revenues

* This chapter was written jointly with Bernd Ebel.

¹ The benefit principle was discussed at some length in Chapter III.

² American Public Works Association, Refuse Collection Practice, (Chicago, 1966).

can be equitably and efficiently gathered by a carefully-thought-out policy of benefit taxation or fee charging."³

Pricing Problems

Fees or prices charged to cover the cost of a service may be based either on marginal costs or average costs. If the price is based on marginal cost, the amount of the charge depends on the cost of supplying an additional unit of service. In the case of average cost the total cost is simply divided by the total number of units produced and each individual is charged the resulting average cost price per unit multiplied by the number of units of service received by him.

There has been a long discussion in the economic literature about the relative merits of marginal cost pricing.⁴ While it is unnecessary to examine the numerous arguments and counterarguments here, it should be pointed out that there are avid proponents of this method of pricing. A thorough review of marginal cost pricing reveals, however, that the requirements for a successful implementation of this system of pricing are so difficult to meet as to render marginal cost

³Mangum, G.L., "The Benefit Principle: An Unexpected Source of Municipal Revenues and Investment Decision", Municipal Finance, February 1962, p. 128.

⁴One of the first to discuss the issue was Harold Hotelling in "The General Welfare in Relation to Problems of Taxation and of Railway and Utility Rates", Econometrica, July 1938.

pricing a mere theoretical concept.⁵ This even applies to public utilities operating under decreasing cost conditions for which marginal cost pricing has been most frequently advocated.

The case for marginal cost pricing as opposed to average cost pricing is strongest for activities which require a relatively large investment in fixed plant, as would apply in the case of an incinerator. However, refuse collection costs greatly outweigh disposal costs;⁶ and collection costs are best paid for through average cost pricing, on both theoretical and practical grounds.

The pricing of municipal services usually takes place under considerable political pressure with the result that political expediency frequently takes precedence over economic considerations. The result is that fees and service charges are usually designed irrationally and that the use of the benefit principle is often haphazard and inconsistent in many cases. An awareness of both advantages and limitations inherent in the use of service charges for government operations, especially for quasi-public services like refuse collection, suggests that rates must be carefully designed and structured.⁷

⁵See Nancy Ruggles, "Recent Developments in the Theory of Marginal Cost Pricing", The Review of Economic Studies, Vol. II, 1949-50.

⁶For example, in the City of Edmonton disposal costs are about 1/5 of the total cost of collection and disposal.

⁷See Jacob A. Stockfish, "The Outlook for Fees and Service Charges as a Source of Revenue for State and Local Governments", Proceedings of the National Tax Association, 1967, (Columbus: National Tax Association, 1968), p. 91.

Bases for Rate Structure

Local governments may use one or more of a variety of rate bases. The choice will depend on the particular objective to be achieved and on local peculiarities such as population density, types of refuse and geographic conditions. The following are commonly used bases:

1. Uniform charge for each service. This simple rate structure does not take into account the quantity of refuse collected. In order to avoid unfair treatment of customers it should be applied only in residential areas which contain predominantly one or two family dwellings.

2. Number of dwelling units or apartments. This is an alternative residential rate base which may be combined with the uniform charge to introduce differential flat rates for single, duplex, and row houses and apartment buildings.

3. Number of containers. The number of containers provides a relatively accurate estimate of the quantity of refuse collected, making it a good measure of the benefit received. If containers of different sizes are used, the service charge could be based on the largest container. This would induce households and businesses to replace smaller containers with those of the maximum allowable size. The administrative work of collection crews would be minimized if the municipality provided its own standard containers.

4. Size of the containers. The size of containers also permits a good estimate of the amount of refuse removed. This method is administratively more involved than the above one

as the choice of the container size is left to the individual. If this rate base was extended to include commercial and industrial establishments, either a maximum limit on the container size would have to be imposed or mechanical loading equipment employed.

5. Measured volume of refuse. The regular service charge can be established on the basis of actual measurements made during a certain number of collections. The City of Edmonton sets the service charges for nonresidential properties in this way.

6. Frequency of collection. This method can be combined with a quantity method when the customer has an option as to the number of collections per week. This would apply more to commercial and industrial customers than to households; the number of collections in residential areas is usually fixed.

In addition to these six rate structure bases there are a number of auxiliary methods for establishing service charges for refuse collections which take local or individual characteristics into account. For example, the floor space of buildings, the distance from collection vehicles to containers, the class of refuse, the promptness of service and the topography of the collection area.

While it appears to be satisfactory to base residential rates primarily on the quantity of refuse collected, for example, through the number or the size of containers, commercial and industrial properties will probably be best served by combining

frequency with quantity as a base and by using large containers of various sizes.

Administrative Considerations

In an appraisal of the service charge method of financing refuse collection services, the administrative overhead costs have to be taken into account because they form a significantly larger part of the total costs than under the system of general revenue financing. Administrative costs are determined mainly by the degree of sophistication of the rate structure and the method of collecting the charges. The more arbitrary the rate structure the lower the costs of billing. These two factors would have to be weighed against each other when setting up the system.

The cost of billing and collecting the charges depends to a large extent on the possibility of utilizing an already existing accounting and billing system. The City of Edmonton, for example, has a Consumer Service Department which handles much of the administrative work for three public utilities--Edmonton Power, Edmonton Telephones, and Edmonton Water. The Department provides application, billing, and collection services and works in close collaboration with the Treasurer's Division and the Data Processing of the Finance Department. The former receives the payment of the bills and the latter processes the bills and records the payments through an electronic data processing system.⁸ The incorporation of

⁸Suski, J.G., Edmonton, (Edmonton: The City of Edmonton, 1965), p. 56.

of the billing procedures for refuse collection service charges into the system of the Consumer Service Department would be cheaper and probably more efficient than setting up a separate system.

Including refuse collection charges in the joint utility bill and making provisions for the discontinuation of all services in case of delinquent refuse collection accounts would instantaneously alleviate the problem of dealing with arrears in payments. The mere interruption of the refuse collection service is impractical as it creates a public health hazard.

The cost of billing and collecting for six American cities, having a city operated service and covering one hundred per cent of the cost of the service through service charges, varied between 2.2 and 9.0 per cent of the cost of the service.⁹ It is interesting to note that the lowest percentage was found in a city which included the refuse service charge on the water bill. By comparison, the city administration overhead for refuse collection and disposal was computed to be 2.75 per cent of operating costs in the City of Calgary.¹⁰ The annual additional operating costs of including a service charge for refuse collection on the utility bill was estimated to be \$10,000 per year, amounting to an additional 0.5 per cent of

⁹Schneider, C., "Refuse Service Charges", The American City, May 1953, p. 92.

¹⁰The City of Calgary, Finance Department, Economic Division, Financing Refuse Collection and Disposal, (Calgary, 1968), pp. 4 and 10.

total operating costs. If these figures indeed reflect the total administrative costs, then administrative considerations would not present an obstacle for the implementation of the service charge method of financing refuse collection and disposal.

Revenue Potential

Municipal governments generally plan to recover only the cost of providing the collection service from service charge revenues, that is, they do not have the intention to make a profit and to add thereby to the general revenue fund. The costs of the service should be understood to include operating cost, depreciation and debt charges, and allowance for expansion. The deliberate pricing of utility services high enough to earn a substantial profit is widely accepted. It may be looked at as a hidden tax and has, due to the regressive nature of service charges, undesirable redistributational aspects. Moreover, as the profits are usually channelled into the general revenue fund, the nonusers of the service, or services, are being subsidized by the users. The argument that the profits constitute a reasonable return on the investment does not really apply because in the case of public utilities the investors are, after all, the customers and any return on the investment should benefit them. The simplest way of doing this is by lowering the price of the service. The profit may, however, be justified on other grounds, for example, on the basis of rating cost of financing requirements for capital.

A comparison of nine Canadian and United States cities with a population of over 100,000 which financed the entire cost of refuse collection and disposal through service charges showed an average per capita revenue of \$4.86 in 1960.¹¹ This figure must be interpreted carefully because the conditions of providing the service varied widely among the cities. If, however, service charges corresponding to this average rate were applied in the City of Edmonton in 1960, the ensuing revenue of \$1,308,866 would have been more than sufficient to pay for the cost of the service which amounted to \$964,986.

Commercial and industrial customers could be served at the same rates that apply to residential customers if they use the same type of container. Rates similar to those above or individual rates would have to be established if bulk containers are used.

Evaluation of Service Charge Financing

In the evaluation of the service charge method of financing refuse collection, the revenue aspect is of paramount importance. It is the pressing need for additional funds at the municipal level that instigated the search for untapped revenue sources. The revenue adequacy will, therefore, carry more weight than any other single factor in the decision about

¹¹Moak, L.L., A Survey of the Use and Non-Use of Service Charges in the Performance of Refuse Collection and Disposal Functions in 380 Local Governments of the United States and Canada, (Chicago: Municipal Finance Officers Association, 1962), pp. 18-22.

acceptance or rejection of this particular method of financing barring political considerations. This is contrasted by Stockfisch's statement that "the most important advantage to be derived from fees and service charges lies in their potential as a means of subjecting programs and operations to the discipline of the market test."¹² The market test with its effect on resource allocation is unquestionably of relevance in the case of refuse collection, especially if it replaces, totally or in part, the political evaluation process governing resource allocation and utilization, but to consider the revenues derived from fees and service charges as a mere "by-product" appears to be an underestimation of the severity of the fiscal problems which confront municipal governments. It has been shown above that refuse collection service charges can be designed in such a way as to produce revenues sufficient to cover the total cost of the service, that is, they meet the criterion of revenue adequacy. This statement is, however, subject to the condition that a relatively inexpensive method of billing and collecting the charges can be found.

Under the system of service charge financing each household only pays according to the benefits received. This ensures a degree of horizontal equity that does not exist if the service is financed out of the general revenue fund. Any kind of equality under the general revenue system appears to incidental to the method of financing.

¹²Stockfisch, "The Outlook", p. 89.

By introducing service charges and establishing the municipal agency as the sole collector a more comprehensive and cheaper service becomes available to all properties in the municipality. The cost of the service to ordinary residential properties is not likely to change very much provided an efficient administrative procedure can be found. The removal of certain classes of refuse, for instance, construction wastes, from residential properties and the removal of trade wastes can, however, be expected to be less expensive than the private collection service. That is so, firstly, because the service can be provided at cost and, secondly, because of the more efficient operation of a single collection agency. The experience of other cities shows that it is advisable to require all properties to use the municipal collection service.¹³ If this is not done, unsanitary conditions or litter problems may result, caused by people who refuse to purchase the refuse service on the grounds that they cannot afford it or that they can dispose of their refuse themselves.

An important consideration is that the system of service charge financing has a high degree of flexibility. This is advantageous in two respects. Firstly, on the financial side, periodic reviews and updating of charges for certain kinds of service are possible, not only when collection conditions change but also in response to increases in the general

¹³American Public Works Association, Refuse Collection Practice, p. 274.

price level. Secondly, on the physical side, this type of financing lends itself to the introduction of charges for new or experimental methods of collection such as containerization. This feature is essential as both collection and disposal methods change under the impact of rapid urbanization and technology.

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CHAPTER V MUNICIPAL INCOME TAX REVENUES¹

Municipal governments may be able to raise revenues by imposing income taxes that are entirely locally administered, or they could attempt to take advantage of one of the forms of sharing arrangement with the provincial government described in Agenda for Provincial-Municipal Fiscal Reform.

An Independent Municipal Income Tax

The purpose of this section is to evaluate a locally imposed and administered municipal income tax and to suggest some of the desirable characteristics that such a tax should have.

Local or municipal income taxes have had a long history in Canada and the United States. Municipal income taxes were in existence in Canada prior to the establishment of the Wartime Tax Agreements in 1941. Both provincial and municipal income taxes were withdrawn as a result of these agreements between the federal and provincial governments. The first modern local income tax to be levied in the United States was imposed in Philadelphia in 1940 and was soon copied by other cities. Currently the number of local income taxes in the United States is well over 1,500. In many cases the yield of the income tax exceeds that of the property tax.

¹A portion of this chapter is based directly on a previous study appearing in Municipal Finance.

The municipal income tax that existed in Canada before World War II was not very productive of revenue; but, for that matter, neither were the national or provincial income taxes. However, since 1941 the taxation of income as a source of government revenue has taken giant steps. It is of interest to note that it was precisely during this period, when no municipal income taxes were used in Canada, that the employment of income taxation at the municipal level was developing as a major source of revenue for many local governments in the United States. Federal-Provincial fiscal arrangements prevented any such development in Canada in the period since the war.

The municipal income tax levies in the United States are quite different from those imposed by the state or federal governments. The local income tax generally applies only to labour income and net business profits, but excludes investment income. In most cases no exemptions or deductions are permitted but the rates are very low and not progressive. Tax liability is based on the income earned by both residents and nonresidents within the geographic boundaries of the municipality. In some cases the income earned by residents outside the local unit is exempt from the tax base.

The current municipal income taxes are open to strong criticism. Evasion of the tax is not difficult, the tax discriminates against wage earners, and equity is lost by the failure to provide personal exemptions and deductions.

These arguments against the local income tax, however, are probably of no greater import than the arguments against the property tax it replaces. Many of the limitations of the local income tax in the United States are primarily the direct consequences of limitations imposed by state constitutions.

In spite of its deficiencies, the local income tax has had a measure of success in the United States, notably in relieving the pressure on property taxes and in taxing residents of outlying suburbs who work in and use city facilities. The adoption of the local income tax by a Canadian municipality could probably result in a more equitable local income tax than the American version, primarily because there are no constitutional limitations on exemptions and progressive rates in Canada.

The Size of the Taxing Jurisdiction

The administrative costs of a municipal income tax increase very rapidly as the size of the local tax unit decreases. This is the result of both the relatively fixed overhead costs and because smaller units are generally less compact, and financially and industrially less developed. This, therefore, suggests that the tax should be limited to concentrated urban areas. Only a crude form of the tax can be profitably used by smaller units. A local income tax administered by a small unit cannot take full advantage of withholding and would find it difficult to attract competent staff.

The experience in the United States suggests that a simple tax on earned income without exemptions or progressive rates can be used by relatively small local units. The tax collector's intimate knowledge of the financial circumstances of local citizens increases the effectiveness of enforcement and collection. It does not seem desirable, however, to follow the pattern in Pennsylvania where local income taxes are levied by jurisdictions with population below 1,000 and the yield only in the hundreds of dollars.

The Tax Base

Wages, salaries and other labour income should be included in the base. These items constitute the minimum base of all local income taxes in the United States. If these were the only items included, the tax would be rightly called a payroll tax. Tax liability for the earned income could be applied to residents either on the basis of all income regardless of source or to income earned only within the taxing unit. There appears to be no logical reason to exclude any income earned by a resident taxpayer. Non-residents should be taxed only on that part of their income earned within the taxing unit. A potential threat to double taxation arising under the preceding rules may necessitate compromises between employment and residence jurisdictions.

Net profits of unincorporated businesses and professions should also be taxed under the municipal income tax.

Net profits of an incorporated business could be part of the local income tax base. The portion of total net profits of a corporation that would be allocated to the taxing unit could be determined by an average of some or all of several ratios such as the following three: each of property, gross receipts, and payroll within the taxing unit to each of total property, total receipts, and total payroll. The inclusion of property in the formula would provide an incentive for corporations to locate beyond the geographic boundaries of the taxing unit. This tendency would be further reinforced by the introduction of payrolls into the formula. This incentive to move would probably be no greater than the one that exists under the property tax. A more serious problem is created by corporations whose activities within the taxing unit are confined only to sales since the existence of such firms would be difficult to establish. In addition, there may be jurisdictional problems in taxing a corporation under such circumstances. In general, competitive inequities would be created between firms whose entire property, sales, and payroll are within the taxing unit and firms whose sales activities are more concentrated within the boundaries of the taxing unit than are its property and payroll.

Questions of equity, measurement, and identity, as well as other administrative problems suggest that it may be desirable to exclude corporate profits from a locally imposed and administered income tax. Pennsylvania, the state with the most extensive experience with local income taxes in the

United States does not subject corporate businesses to its tax. Some other parallel, more centralized, program of taxing corporations would probably have to be introduced as an alternative to local income taxation.

The arguments presented in favour of excluding corporate profits hold almost as equally well for excluding non-corporate profits. No readily available solutions appear regarding the advisability of including or excluding business profits from the local income tax base. If a property tax continues to exist, then property income should be exempt. It may be argued, however, that the exclusion of property income is inequitable since such income is received primarily by higher income groups. Income from investments, such as interest, dividends, and royalties should be exempt for administrative reasons. A local unit could not adequately police the reporting of investment income, unless, of course, it had access to federal income tax records.

Personal Exemptions

At first view, equitable treatment would suggest the introduction of exemptions. Exemptions also facilitate at least one aspect of administration by reducing the number of taxable returns that would have to be made. However, it must be borne in mind that exemptions reduce the taxable base (necessitating higher rates on remaining income), complicate the collection process, and reduce the stability of revenue yields. To some extent, it can be argued that even without

exemptions the local income tax is a great deal more equitable than the property tax and further equity would be desirable only if the non-use of exemptions would in fact create unacceptable burdens. Given the low tax rates and the problems created by exemptions it is doubtful if serious objection could be raised to the tax burdens created by a local income tax without exemptions.

On the other hand, if personal exemptions were deemed desirable for equity reasons, they could be readily introduced without undue concern over the adverse administrative effects they may have. There is probably no strong plea to be presented for either approach. If personal exemptions are allowed, the effective tax rate will be progressive without the use of progressive rates. The argument for progressive rates is much less defensible on equity grounds than the argument for the use of personal exemptions. It is very likely that the shift from property to income taxation will in itself greatly increase the progressivity of the tax structure. Progressive rates would create administrative problems arising from attempts by the taxpayer to manipulate the timing of income and expenses and attempts to devise income-splitting techniques. Progressive rates also intensify equity problems in the definition of taxable units.

Cost of Administration

Experience in the United States suggests that the cost of administering a local income tax would range from

2% to 5% of revenue yield. The cost-yield ratio depends upon the size of the jurisdiction, the degree of industrialization, the tax rate, and the effectiveness of administrative efficiency enforcement.

The preceding evaluation leads to the conclusion that a locally imposed and administered income tax should be restricted to larger urban centres. The tax base should include all labour income. Business profits should be included only if they cannot be taxed more effectively by some alternative method. The tax base should exclude property income (if property is being taxed) and investment income. No strong case can be made for the introduction of personal exemptions and progressive rates.

Revenue Estimates of an Independent Local
Income Tax

The following procedure is used for estimating the revenue of a local income tax without exemptions for the City of Edmonton for the year 1969:

1. Estimate total personal income by income groups.
2. For a given tax rate structure multiply the total income of each income group by the rate that applied to that group.
3. Total the revenue obtained from each income group.
4. Repeat this procedure for each different type of tax rate structure.

Table 5-1 gives revenue estimates for three alternative tax rate structures without exemptions. The tax base is assumed to be personal income as measured by the Dominion Bureau of Statistics. The estimate for Edmonton is based on the amount of income reported for income tax purposes compared to total personal income in the province of Alberta.

If the exemptions used in the federal income tax structure were applied to the local tax, a total of approximately \$300 million in income would be exempt from taxation. As a result a 2 per cent income tax with exemptions would yield approximately \$27 million in revenue compared to \$33 million without these exemptions.

Neither exemptions nor progressive rates change the amounts of revenue produced sufficiently to justify the additional administrative complications.

TABLE 5-1 Estimated Revenue from Local Income Taxes Under Alternative

Rate Structures, Edmonton, 1969

Income Group	Estimated Personal Income (,000,000)	Structure I		Structure II		Structure III	
		Rate	Revenue (,000)	Rate	Revenue (,000)	Rate	Revenue (,000)
under \$ 1,000	\$ 20	2	\$ 400	1	\$ 200	1	\$ 200
\$ 1,000 - 1,999	51	2	1,020	1	510	1	510
2,000 - 2,999	75	2	1,500	1	750	1	750
3,000 - 3,999	111	2	2,220	1	1,110	1	1,110
4,000 - 4,999	123	2	2,460	1	1,230	1	1,230
5,000 - 5,999	312	2	6,240	2	6,240	2	6,240
7,000 - 9,999	432	2	8,640	2	8,640	2	8,640
10,000 - 19,999	407	2	8,140	2	8,140	3	12,210
20,000 and over	129	2	2,580	2	2,580	3	3,870
Total	\$1,660		\$33,200		\$29,400		\$35,760

Sources: Taxation Statistics, 1969, Department of National Revenue, Ottawa, 1971.
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CHAPTER VI MUNICIPAL SALES TAX REVENUES

Historical Development

The first municipal sales tax levied in Canada was introduced in Montreal in 1935 as a direct consequence of the revenue requirements arising from heavy relief payments. The City of Montreal also took the opportunity, at that time, to impose a local personal income tax.

The Montreal retail sales tax followed the first American municipal sales tax by a year and preceded the Quebec provincial retail sales tax by five years. The rate was set at two per cent (the rate set by the City of New York in 1934 was also two per cent). The tax was levied on the retail sales of all goods except food and a few other minor items.

Six other Quebec cities adopted the municipal retail sales tax between 1940 and 1943. In 1949 school districts were given authority to levy sales taxes and many of these quickly took advantage of the permission. These school taxes were incorporated into the provincial tax at a uniform rate of 2 per cent in 1961 when the provincial tax rate was raised from 2 to 4 per cent. Currently, Quebec has replaced the municipal taxes with a provincial sales tax, revenues from which are distributed in the form of grants.

The adoption of local retail sales taxes had progressed more rapidly and widely in the United States than in Canada, spreading from the City of New York in 1934 to more

than half the cities of over 100,000 population in 23 states by 1971.

Municipal governments are the creation of provincial legislatures and must conform to the constitutional tax restriction imposed on the provinces that limits provinces to "direct taxation within the province". There is no reason to suppose that local retail sales taxes would be barred as long as provincial sales taxes continue to be permitted. Beyond this there is virtually no conceivable limit on the privileges that may be granted by the provinces to their local governments in implementing local sales taxes.

The tax bases of local sales taxes in the United States are usually much the same as those at the state level. In cases where the local tax is administered by the state the two tax bases are identical.

Local sales taxes can be divided into two major groups: those that are locally imposed and administered and those that are administered by the province or state. The municipal retail sales tax in Quebec was administered by the provincial government from 1940 until it was abandoned. The first state administered local sales tax in the United States was put into operation in 1955. Most of the other state-administered taxes were introduced almost immediately after.

Table 6-1 shows the extent to which local sales tax revenues were used in Quebec by 1960.

TABLE 6-1 QUEBEC MUNICIPAL SALES TAX, 1960

Type of Municipal Unit	All Municipalities in Quebec		Municipalities Using Local Sales Tax			
	Number	Property Tax Revenue	Number	Revenue from Sales Tax		
				Property Tax Revenue	Per Cent of Property Tax Revenue	
City	55	\$ 76,520,000	47	\$72,120,000	36,284,000	50
Town	174	15,132,000	78	8,884,000	4,548,000	51
Rural	1446	12,163,000	92	971,000	1,218,000	125
Total	1675	\$103,817,000	217	\$81,975,000	42,050,000	51

Source: 1960 Municipal Statistics, Quebec Bureau of Statistics, (Quebec, 1962) pp. 246-305.

A Locally Administered Municipal Sales

Tax in Alberta

A locally administered tax can exist under two distinct sets of conditions:

- (1) the province has no retail sales tax of its own, or
- (2) the province also imposes a retail sales tax. Only the first of these is relevant to the current situation in Alberta.

The advisability of a local sales tax operated under provincial-local shared tax arrangements is discussed in Agenda for Provincial-Municipal Fiscal Reform.

A locally imposed and administered retail sales tax for Alberta municipalities would follow the pattern currently existing in the state of Alaska, where there is no sales tax at the state level.

The procedures necessary to impose a locally administered municipal sales tax will be illustrated by a proposal to levy a sales tax in the City of Edmonton. First, anyone doing retail business in Edmonton would be required to register with the city and submit copies of returns similar to those currently used by the provincial government with sales taxes. Firms doing business in other parts of Alberta would be required to separate the sale items taxable in Edmonton from total sales. Additional separation of accounts would be required if non-residents of Edmonton were exempt from the tax on their purchases in Edmonton.

It is difficult to obtain adequate data on the cost of administration of local sales taxes. The data that is available is not directly comparable to the situation in Edmonton. The interpretation of collection costs is complicated by the fact that low costs of collection may be the result of lax enforcement and not administrative efficiency. A 2 per cent tax would cost about 2 per cent of revenues.¹

If purchases by non-residents of Edmonton were exempt from the local sales tax (the procedure followed in Quebec) then several undesirable consequences would arise. For one, the retailers' compliance costs and the city's auditing costs are bound to increase. Secondly, more opportunity would be created for tax evasion. An incentive for delivery of expensive items to out-of-Edmonton friends or relatives would be created. Thirdly, the demands for delivery beyond city limits of all purchases made by non-residents as proof of exemption would increase the retailers' costs of operation. Finally, inequity would arise from the inability of the authorities to enforce this provision effectively.

On the other hand, non-exemption of purchases by non-residents of Edmonton would encourage the shifting of purchases from Edmonton. If the tax rate was low, this effect may not be too serious. Nonetheless, some differential incentive

¹Due, J.F., Sales Taxation, (London: Routledge and Kegan Paul, 1957), p. 329.

to establish a shopping area just outside the jurisdiction of Edmonton would still exist. "Shop Here and Save Edmonton's Sales Tax" signs would begin to appear. This problem would virtually disappear, of course, if the municipalities around Edmonton were to impose a similar sales tax. However, unless the local tax were used by all local units in the province (this would make it difficult to defend local administration), the problem would only be shifted to some other municipality. It is difficult to avoid the conclusion that a local sales tax would influence the location of industry on non-economic grounds.

Not only would non-Edmontonians prefer to shop outside Edmonton but Edmontonians themselves would be given an incentive to make their purchases beyond the city limits. Legally, a use tax could be employed to prevent Edmontonians from escaping the tax through outside purchases. All purchases brought in to Edmonton would be subject to taxation. However, little reflection is needed to realize the ineffectiveness of such a provision. Not all of the undesirable effects are economic in nature. Inequity would arise since some Edmontonians would be in a better position than others to make outside purchases either on an occasional or regular basis.

The revenue from a sales tax is generally considered to be more stable than the revenue from an income tax and less stable than the revenue from the property tax. This is true primarily because as economic activity fluctuates income

fluctuates relatively more than the amount of consumer expenditures which in turn fluctuate more than the value of real property.

Experience has shown, however, that the sales tax revenue may be more stable than the property tax revenue even if the base on which the sales tax is based is less stable. Fluctuations in income tend to cause fluctuations on arrears on property taxes. The flow of revenue from a property tax is less stable than the value of the property on which it is based. Since arrears are not possible under the sales tax, revenue is as stable as the value of sales. The experience in Montreal tends to bear this out.²

City taxes are not likely to be as productive as provincial taxes levied at the same place and rate. The city may collect as little as 70 per cent of the amount that the province would have been able to.³

²Canadian Tax Foundation, "The Retail Sales Tax - An Evaluation", Local Finance, (Toronto: Canadian Tax Foundation, 1969), p. 3.

³Glander, C.E., "New Types of Municipal Non-Property Tax Revenue", National Tax Journal, June 1950, p. 99.

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CHAPTER VII VALUE-ADDED TAX

The value-added tax is a relatively new tax form. It has been employed in a modified form on the national level in France since 1954 and on the state level in Michigan between 1953 and 1967. Currently eight European countries use the value-added tax: France, West Germany, Netherlands, Luxemburg, Belgium, Denmark, Norway and Sweden; and the tax is being seriously considered by Great Britain, Italy, Ireland, Austria and Switzerland. Either the legislation or the concept of valued-added taxation in one form or another has appeared in California, Indiana, Michigan, Oregon, West Virginia and in the city of New York.¹

The value-added tax raises very little enthusiasm among some economists. For example, John F. Due thinks that the value-added tax offers little in the way of basic reform.² Other economists, however, see the tax as a panacea for all our troubles. One of the more forceful advocates of the valued-added tax currently in the United States is Richard W. Lindholm.³ Lindholm believes that the value-added tax

¹Papke, J.A., "Discussion", National Tax Journal, September 1971, p. 415.

²Due, J.F., "Discussion", National Tax Journal, September 1971.

³Lindholm, R.W., "Towards a New Philosophy of Taxation", The Morgan Guaranty Survey, January 1972.

can also play a useful role in providing funds for local governments.⁴ The strongest case for local adoption of the value-added tax in the United States has been made by George F. Break.⁵

Value-Added

Value-added by the activities of any business firm is measured by the difference between sales receipts and the expenditures on items purchased from other business firms. The difference is made up of payments to individuals such as wages, salaries, rent and interest, and the profits earned by the firm. These payments represent the rewards paid to the factors of production. The aggregate value of these items measures the total national income of the economy.

A more comprehensive definition of value-added includes sales receipts minus raw material (non-capital goods) purchases from other firms plus changes in inventory minus depreciation charges. A clarification of the value-added tax can be obtained from a numerical example involving the calculation of tax liability by business firms. Table 7-1 sets out the interrelation among Firms A, B and C and the consumer. Firm A produces only capital goods, Firm B only raw material and Firm C only consumer goods.

⁴Lindholm, R.W., "Integrating a Federal Value Added Tax with State and Local Sales Levies", National Tax Journal, September 1971.

⁵Break, G.F., Agenda for Local Tax Reform, (Berkeley: University of California, 1970).

TABLE 7-1 PURCHASES AND SALES IN THE ECONOMY, AN EXAMPLE

S A L E S			
	Firm A	Firm B	Firm C
	<u>Capital</u>	<u>Raw Materials</u>	<u>Consumer Goods</u>
	\$	\$	\$
PURCHASES			
Firm A		3	
Firm B	2.5		
Firm C	2.5	7	
Consumers			23
Total	5.0	10	23

The value-added by each firm and the entire economy is shown in Table 7-2.

The accounting and tax liability calculations for value-added tax follows the concept employed by Statistics Canada in measuring Canada's aggregate national income (or output). Value-added is directly equated with net national income.

An alternative method of calculating value-added arises from differences in the treatment of inventories and capital depreciation. This method, which can be called the sales type, permits the deduction of all capital equipment purchased during the year. This contrasts with the annual depreciation charges allowed under the income type of the value-added tax. In effect, the sales type allows 100 per cent depreciation in the year of purchase. In addition, the sales type ignores inventory changes. Figure 7-1 compares the two forms of accounting for a given business firm. An analogy can be drawn between income and sales type of value-added accounting on the one hand and accrual and cash accounting respectively on the other.

The sales type of value-added is calculated in Table 7-3.

The income and sales type of value-added tax yields the same results over a long period of time (unless, of course, interest is allowed in order to equate the irregular

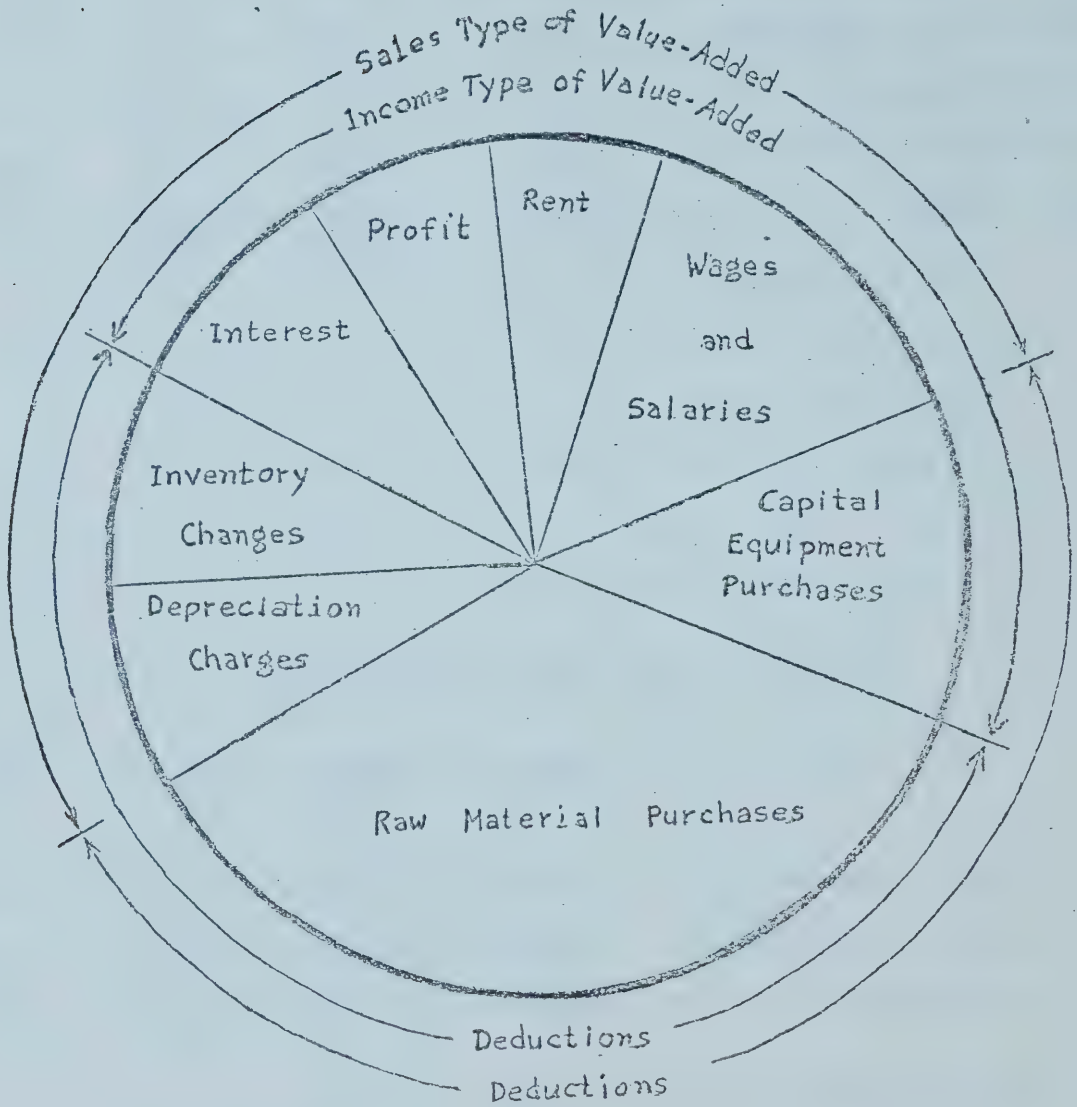
TABLE 7-2 INCOME TYPE OF VALUE-ADDED

	<u>Firm A</u> \$	<u>Firm B</u> \$	<u>Firm C</u> \$	<u>Total</u> \$
Sales Receipts	+5.00	+10.00	+23.00	+38.00
Raw Material Purchases	-3.00	0.00	- 7.00	-10.00
Inventory Change	0.00	0.00	+ 2.00	+ 2.00
Depreciation Charges (20%)	<u>0.00</u>	<u>- 0.50</u>	<u>- 0.50</u>	<u>- 1.00</u>
Value-Added	<u>\$2.00</u>	<u>\$ 9.50</u>	<u>\$17.50</u>	<u>\$29.00</u>

TABLE 7-3 SALES TYPE OF VALUE-ADDED

	<u>Firm A</u> \$	<u>Firm B</u> \$	<u>Firm C</u> \$	<u>Total</u> \$
Year One				
Sales to others	+5.00	+10.00	+23.00	+38.00
Purchases from others	<u>-3.00</u>	<u>- 2.50</u>	<u>- 9.50</u>	<u>-15.00</u>
Value-Added	\$2.00	\$ 7.50	\$13.50	\$23.00
Second and Subsequent Years				
Sales to others	0.00	7.00	23.00	30.00
Purchases from others	<u>0.00</u>	<u>0.00</u>	<u>- 7.00</u>	<u>- 7.00</u>
Value-Added	<u>\$0.00</u>	<u>\$ 7.00</u>	<u>\$16.00</u>	<u>\$23.00</u>

Figure 7-1. Income and Sales Type of Value-Added



tax payment patterns over the time period involved). In the income type, Firms B and C eventually depreciate the remainder of their capital assets and Firm C's inventory finally disappears; reducing value-added to \$23.

The two methods of accounting have given rise to such statements as:

"This levy is so new that there is still some doubt about whether it falls in the sales, or in the income, tax family - the Bureau of the Census, indeed, prefers to place the Michigan tax in the anomalous category entitled 'other'".⁶

"Since wages comprise most of value-added, the value-added tax is largely a payroll tax".⁷

"The value-added tax is a tax on sales".⁸

"A value-added tax is therefore a tax on the total income of the economy".⁹

"Total value added is the same as total retail sales, in principle, at least in a stabilized economy ..."⁹

⁶Rolph, E.R. and Break, G.F., Public Finance, (New York: Ronald Press, 1961), p. 280.

⁷Poole, K.E., Public Finance and Economic Welfare, (New York: Rinehart, 1956), p. 267.

⁸Norr, M., "Sales Taxes in Europe and Canada", Report of Proceedings of the Sixteenth Annual Tax Conference, (Toronto: Canadian Tax Foundation, 1963), p. 246.

⁹Shoup, C.S., "Theory and Background of the Value-Added Tax", Proceedings of the National Tax Association, 1955, (Sacramento: National Tax Association, 1956), p. 7.

Uncertainty and division of opinion about the actual nature of the value-added tax is reinforced by the fact that of the two jurisdictions first employing the tax, one, France, used the sales type, and the other, the State of Michigan, used the income type; and both of these taxes were far removed from the pure form of the value-added tax.

It must be made clear that although the income type of value-added tax has the same gross base as the income tax, there is a very real difference between a value-added tax and an income tax. This is true because income tax liability varies not only with the size of income and the tax rate structure but also with the individual characteristics of the taxpayer. Equal amounts of income are not subject to the same amount of tax; whereas, equal amounts of value-added are liable for the same amount of tax.

On the other hand, a pure retail sales tax based on all consumer goods and service would not have the same corresponding real difference from the sales type of value-added tax. Equal amounts of sales or value-added would in each case be liable for the same tax payment.

Economic Evaluation of the Pure Form of Value-Added Tax

In all probability the value-added tax is relatively neutral as far as economic effects are concerned. The tax does not significantly influence the allocation of resources among industries. It is possible, however, that the tax may

give some incentive to alter the consumption-savings ratio. This would change the rate of capital formation and affect economic development.

It is not an easy matter to arrive at precise and defensible conclusions on the economic effects of the value-added tax. Of prime concern to such analysis is the degree and nature of shifting and incidence of the tax burden involved. Unfortunately, the final incidence of the value-added tax is somewhat obscure. Most economists that have investigated the value-added tax agree that both forms of the tax are shifted and presumed to be paid chiefly by the consumer. John F. Due, for example, suggests that both forms of the tax should be regarded as sales taxes that would raise "the prices of consumption goods relative to income received by factors".¹⁰ On the other hand, Arnold Harberger states that the "income-type tax will be borne proportionally by all factors of production".¹¹

A shifted tax may reduce consumption but not enough to be significant. The effect on investment would likewise be of minor economic consequence. A shifted value-added tax would in all likelihood create a pattern of tax burden distribution similar to that of a general retail sales tax. The effects on consumption, savings, and investment would

¹⁰Due, J.F., "The Value-Added Tax", Western Economic Journal, Spring 1965, p. 170.

¹¹Harberger, A.C., "A Federal Tax on Value-Added", The Taxpayer's Stake in Tax Reform, (Washington: Chamber of Commerce of the United States, 1968).

be much the same as under the sales tax. There would be little reason, then, to justify the existence of a value-added tax on economic grounds. The sales tax could provide the same results in a much less complicated manner.

However, if the tax was borne directly by business firms it would create disincentive effects on investment. The payment of the tax would directly remove some of the funds that would otherwise be available for expansion. The tax would also reduce the inflow of outside capital funds since the net return available to such funds would be reduced by the tax. These disincentive effects on investment are likely to be reduced somewhat by the sales type of value-added tax because of the fact that capital expenditures are fully deductible from the tax base in the year of purchase.

An unshifted value-added tax would increase the incentive to consume, both because saving funds would receive a lower rate of return and because the lesser burden on consumers would stimulate larger expenditures on consumer goods.

Although there is no denying the existence of the above tendencies there is little reason to suppose that any of them would be quantitatively important.

Michigan's Value-Added Tax

Michigan's value-added tax, or the Business Activities Tax, as it was officially known, applied to all forms of incorporated and unincorporated business activity, including

manufacturing, wholesaling, and retailing. Agriculture, public utilities, transportation, the services, and the professions were all included in the base.

The tax was based on value-added or the "adjusted receipts" of business firms. Adjusted receipts were calculated by adding all gross receipts from sales and subtracting all regular purchases from others except purchase of capital equipment with a useful life exceeding one year. Other expenditures that were deducted in computing adjusted receipts included all taxes other than on income, interest, rent and depreciation on real property. The deduction of depreciation on real property and the exclusion of capital purchases made the Michigan Business Activities Tax more of an income type than a sales type of value-added tax. But, since no deduction for depletion or depreciation of personal property was allowed, the tax was at least one full step short of being a pure income type of value-added tax.

No specific commodity exemptions were permitted but certain types of businesses, primarily financial institutions, were exempt. These businesses were subject to other types of specific taxes.

Michigan's value-added tax provided very liberal exemptions and deductions in computing tax liability. All businesses were permitted to deduct a minimum of 50 per cent from gross receipts even if actual allowable deductions were less than this amount. In addition, half of all payroll

expenditures exceeding 50 per cent of gross receipts were deductible to an additional maximum of 10 per cent of gross receipts. Finally, a standard statutory exemption of \$12,500 was given to every taxpayer, which in effect excluded from tax all businesses with gross receipts below \$25,000.

After the above exemptions a tax credit based on net income was allowed. The credit ranged from 1 to 25 per cent of total tax liability. Firms with net income of up to 4 per cent of adjusted receipts were allowed a 25 per cent tax credit. On the other end of the scale, firms with net income equal to or exceeding adjusted receipts obtained a 1 per cent tax credit. The precise formulation of this tax credit (within the limits of 1 per cent and 25 per cent) was:

$$\text{tax credit} = \frac{\text{adjusted receipts}}{\text{net income}}$$

The original tax rates were set at 0.1 per cent on public utilities and 0.4 per cent on all others. These rates were raised to 0.15 per cent and 0.65 per cent on July 1, 1955, and to 0.2 per cent and 0.775 per cent respectively on July 1, 1959. The rates remained at this level until the tax was repealed in 1967.

The Michigan value-added tax deviated from the basic theoretical principles implicit in a logical value-added tax in ways that are difficult to justify. The more significant deviations are evaluated in the following list:

(1) By setting a maximum of 50 per cent of gross receipts that need to be included in the tax base, the Michigan tax discriminated in favour of products processed through stages which add large amounts to the value of the product.

(2) The exemption of \$12,500 from tax liability, coupled with the above minimum deduction, exempts all taxpayers with gross receipts of not more than \$25,000. This provision does not give relief to small businesses and professions on the basis of either productivity or income. The relief is based on the relative and absolute size of value-added. Certainly, some other more equitable method can be devised to accord favourable treatment to small businesses (if such favourable treatment is necessary) without distorting the base of the value-added tax.

(3) The Michigan tax did not permit the deduction of capital expenditures nor did it permit the deduction of depreciation charges except on real property. The pure form of the value-added tax allows either the deduction of capital expenditures (sales type) or the deduction of depreciation charges on such expenditures (income type). This deviation in the Michigan tax created a double liability on most purchases of capital goods. Products requiring large amounts of personal capital assets in their production process were discriminated against.

(4) The deduction of interest and dividend payments can be justified only if such payments are made to parties who are subject to the value-added tax. Deductibility should be denied if payments were made to non-taxpayers, since in such

cases the payments constitute value-added. Most interest and dividend payments in Michigan were made to individuals or exempt financial institutions.

(5) The net income credit permitted by the Michigan tax contradicts the philosophy of the value-added tax which implies differential tax liabilities based on variations in value-added during production. The existence of any net income (or loss) should have no bearing on the tax liability.

The French Value-Added Tax

The value-added tax in France applies to manufactures, importers, building contractors, retail establishments, wholesalers and several other classes of firms by option.

Manufacturing includes the usual types of activities in this category except that agriculture is excluded. Artisans are not subject to the tax. Small manufactures have the choice of optioning out of the value-added tax in favour of a services tax (a special tax in France levied on all services).

All individuals and firms that import taxable goods are subject to the value-added tax. Building contractors, previously paying the services tax, are now subject to the value-added tax.

Retailers who operate more than four outlets or make more than one half of their sales at wholesale pay the value-added tax. This provision is designed to equalize the burden between integrated and small retailers. Wholesalers used to

have the option of paying the value-added tax or becoming subject to the local sales tax based on gross sales. This local sales tax was abolished in 1968.

Some firms may become voluntary taxpayers by option if their activities are not normally taxed but they derive an advantage from paying the tax so as to enable persons with whom they have business connections to deduct the tax payment from their liability at a subsequent stage of production or marketing.

There are two steps in calculating the tax liability payable by the seller. The total actual sales price is used as the base for determining a tentative tax liability. Sales to subsidiaries are priced at the same level as sales to independent firms. Retail sales by taxpaying firms are priced at reduced rates to approximate the wholesale price. The amount of the tax itself is included in the tax base. Thus if the nominal tax rate is 20 per cent the effective or actual rate will be 25 per cent.

$$\text{effective rate} = \frac{\text{nominal rate}}{100\% - \text{nominal rate}}$$

This means that a sale of \$100 will be taxed \$25 if the tax rate is 20 per cent.

Next, taxes paid on all previous purchases are deducted from the tentative tax liability. Since taxes on all capital goods purchased are deducted at full value, the French value-added tax is of the sales type. Deduction is permitted

only if the purchases are for production and not for personal use and the purchased items are used to produce goods subject to the value-added tax. No deduction of taxes paid is allowed on purchases of building materials other than for factories, motor vehicles (except those used for internal operation), and office furniture in order to prevent tax avoidance for non-business use.

Exempts include: exports, for which credit is given on taxes paid prior to export; some widely consumed products that are basic necessities; wine, cider, tea, coffee, and petroleum products are exempt but taxed more heavily under another tax; and agricultural products sold in natural state or after only minor processing.

Tax rates range from 7.5 per cent on some widely used goods such as flour and sugar to 33 1/3 per cent on several categories of luxury items. France uses four different types of rates in all.

A Value-Added Tax in Alberta

George Break recently recommended a value-added tax for the state of California either on the state or local level. He defended his position in the following manner:

"As a means of financing non-priced local governmental services to business, the value-added tax has much to recommend it. It alone among all of the possible alternatives would levy for those services a charge that was proportioned to the productive activity carried out by the recipients. With a high degree of neutrality among different kinds of business,

different methods of production and financing, and different forms of organization, the value-added tax is capable of raising substantial amounts of revenue at relatively low tax rates."¹²

Break also stresses the growth elasticity of the tax. The Michigan tax, for example, was nearly as sensitive to changes in income levels as the personal income tax.

Robert D. Ebel calculated the income elasticity of the tax at 1.49 for the last eight years of its duration in Michigan.¹³

There is no reason to expect any insuperable administrative problems. The following comment represents what seems to be a consensus of opinion about the value-added tax:

"The Michigan experience demonstrates that the taxation of value-added is technically feasible and can be carried out with a minimum of administrative difficulties."¹⁴

Although the value-added tax seems to have desirable features, it would appear to add nothing of measureable value to Alberta's current tax structure except as an alternative to imposing a retail sales tax. On the local level a value-added tax could serve as a useful complement to a personal income tax if a net profits tax was not used.

¹²Break, G.F., op. cit., p. 127.

¹³Ebel, R.D., "Michigan Business Activities (Value-Added) Tax", Proceedings of the National Tax Association, 1968, (Columbus: National Tax Association, 1969), p. 94.

¹⁴Papke, J.A. "Michigan's Value-Added Tax After Seven Years", National Tax Journal, December 1960, p. 363.

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CHAPTER VIII AGENDA FOR MUNICIPAL REVENUE REFORM

Introduction

Two types of revenue reform measures can be instituted to aid municipal governments to discharge their responsibilities on their own. One of these is to look for new local revenue sources and the other is to improve the existing revenue structure.

New Revenue Sources

The analysis undertaken here suggests that municipal governments would be well advised to avoid any new forms of general taxation. For a variety of reasons, locally imposed and administered income, sales and value-added taxes all fail as practical alternatives to the property tax.

Although there may be some merit in raising some revenue through new user charges, the prospects of raising large amounts are not too promising.

Property Tax Improvements

The most urgent property tax reform is the rationalization of the distribution of its burden among taxpayers. This reform can be achieved only by abandoning traditional conceptions and attitudes, with a fundamental shift in emphasis away from the characteristics of the property tax base towards the personal circumstances of the taxpayers.

Reforms must attempt to adjust tax burdens according to the accepted principles of fairness based on ability to pay and benefits received. More ability to pay or more benefits requires more tax. Equal ability to pay or equal benefits requires equal tax payments. The first of these is referred to as vertical equity and the second as horizontal equity.

Vertical Equity

Most of the tax levied on business property and a portion of that levied on residential property represents payments for benefits received through police and fire protection, public works and related services. This leaves most of the remainder of the property tax (according to Table 2-3, nearly 2/3 of the total) to pay for education, a portion of which can be justified according to the ability-to-pay principle. However, since the property tax pays for less than 2/5 of the total costs of education in Alberta,¹ a significant portion of the tax represents payments for private benefits of education. (A more complete discussion of private and public benefits of education is undertaken in Agenda for Provincial-Municipal Fiscal Reform.)

The property tax is often vigorously condemned because it is regressive (the higher the income of the taxpayer

¹Canadian Tax Foundation, Provincial and Municipal Finances, 1971, (Toronto: Canadian Tax Foundation, 1971) p. 159.

the lower the effective tax rate). However, expert opinion is beginning to de-emphasize this characteristic by noting that other taxes in the system can more than offset the regressiveness of the property tax, that the tax is regressive is a problem mainly, if not only, at the lowest income levels (see Tables 3-1, 3-2 and 8-1), and that the income redistribution effects of progressiveness is more efficiently handled by senior levels of government. The only reform needed is to remove the excessive burden on the low income groups.

The property tax also fairs out quite well under the benefit principle. Table 8-2 shows that benefits from education (as measured by the number of school-aged children) are more regressive than the property tax, making the net benefits of the tax quite regressive above the \$2,000 income level. The higher the income the lower is the relative benefit. Similar results have been obtained in the United States.²

The excessive property tax burden levied on the poor is unfair on the basis of both ability to pay and benefits received. The solution to this vertical inequity is quite obvious: offer direct tax relief to the low income groups.

In the United States, for example, nearly 1/2 of the states have passed legislation enabling local governments to grant property tax relief for the aged (with a variety of

² Tax Foundation Inc., Tax Burdens and Benefits of Government Expenditures by Income Class, 1961-65, (New York: Tax Foundation, Inc., 1967).

TABLE 8-1 EFFECTIVE PROPERTY TAX RATE FOR
ADJUSTED BROAD INCOME,¹ CANADA, 1961

<u>Family Income Class</u>	<u>Effective Property Tax Rate</u>
Under \$2,000	8.0
\$ 2,000 - \$2,999	4.9
3,000 - 3,999	4.5
4,000 - 4,999	4.3
5,000 - 6,999	4.0
7,000 - 9,999	4.0
10,000 and over	4.1

¹Adjusted broad income is personal income similar to the concept used in National Accounts adjusted by adding government expenditure and transfer benefits and subtracting taxes.

Source: Gillespie, W.I., The Incidence of Taxes and Public Expenditures in the Canadian Economy, Studies of the Royal Commission on Taxation, No. 2, (Ottawa: Queen's Printer, 1964), Table A-7, p. 204.

TABLE 8-2 PROPERTY TAXES AND EDUCATION BENEFITS
AS A PER CENT OF FAMILY INCOME, CANADA, 1961

<u>Income Class</u> (1)	<u>Education Benefits</u> (2)	<u>Property Taxes</u> (3)	<u>Net Property Tax Benefits, (2) - (3)</u> (4)
Under \$2,000	18.3	16.3	2.0
\$ 2,000 - \$2,999	11.4	6.8	4.6
3,000 - 3,999	9.5	5.4	4.1
4,000 - 4,999	7.7	4.8	2.9
5,000 - 6,999	6.5	4.3	2.2
7,000 - 9,999	4.3	4.0	0.3
10,000 and Over	2.5	3.8	-1.3

Source: Gillespie, W.I., The Incidence of Taxes and Public Expenditures in the Canadian Economy, Studies of the Royal Commission on Taxation, No. 2, (Ottawa: Queen's Printer, 1964), Table 2.3, p. 65 and Table 3.8, p. 143.

income and property constraints). In Canada, a meager start has been made in several provinces. For example, Nova Scotia exempts, under certain conditions, a portion of the property of widows and infants. New Brunswick exempts "the property of a woman, not supported by a husband, to the amount of \$4,000 if the total assessed value of her property does not exceed \$20,000 and her total annual income does not exceed \$3,000."³ Manitoba's The Soldier's Taxation Relief Act permits councils to exempt pensioned widows of soldiers and their pensioned widowed mothers from a limited amount of property taxes.

The most interesting scheme in the United States is the one developed in Wisconsin, long a leader in property tax reform, where relief is granted to homeowners and renters who are 65 years of age or older with incomes below \$3,500. This scheme not only reduced the burden of the aged but also changed the highly regressive distribution of the burden for incomes below \$3,500 into a proportional tax with the exception of those with income below \$500. This remarkable redistribution of tax burdens is illustrated in Table 8-3.

The Wisconsin scheme is unique in that it explicitly recognizes the tax borne by tenants by assuming that 1/4 of all rents paid represent property taxes passed on to them by the landlord.

³ Finnis, F.H., Property Assessment in Canada, (Toronto: Canadian Tax Foundation, 1970), p. 45.

TABLE 8-3 TAX BURDEN BY HOUSEHOLD INCOME CLASS,
BEFORE AND AFTER TAX RELIEF,¹ WISCONSIN, 1960

<u>Household Income Class</u>	<u>Tax Burden Before Relief</u> %	<u>Tax Burden After Relief</u> %
\$ 1 - 499	58	16
500 - 999	22	6
1,000 - 1,499	16	8
1,500 - 1,999	13	8
2,000 - 2,499	11	8
2,500 - 2,999	10	8
3,000 - 3,500	9	8

¹Relief is granted to homeowners and renters who are 65 years of age and older with income below \$3,500.

Source: Quindry, K.E. and Cook, B.D., "Humanization of the Property Tax for Low Income Households", National Tax Journal, September 1969.

Relief to the aged not only corrects the inequity based on ability to pay, it also goes a long way toward reducing the burden in line with benefits received. In Table 8-2, for example, the average net benefits to the aged in the under \$2,000 income group are more likely to be -16.3 per cent of income than the +2.0 per cent of income for all families.

Horizontal Equity

There is still the problem of horizontal equity — equal tax burdens for equal ability to pay and equal benefits. The solution for the residential property tax lies in making sure that equal consumption of housing (owner-occupied or rental) is assessed equally for tax purposes. All residential property must be assessed fairly as between single and multi-unit accommodations and as between low-cost and expensive housing. This should achieve reasonable horizontal equity based on ability to pay and should improve benefit equity.

For horizontal ability to pay purposes, non-residential property taxation must be restricted to property that is a part of the community as a whole, such as commercial establishments that pass on the tax burden throughout the community. This would be in addition to tax payments for benefits received.

Taxation of non-residential, special purpose property should be limited to the direct benefits provided to the property itself. The owners of such property already bear their

share of the burdens equally with others and any additional burden would be grossly unfair.

Agenda for Municipal Revenue Reform

1. No new general non-property taxes should be levied.
2. The possibility of some new user charges should be investigated.
3. The equity of the property tax should be improved in one or more of the following ways:
 - a) Exempt the aged from the education portion of the property tax.
 - b) Exempt all or a portion of property taxes for taxpayers below a certain level of income (and/or property).
 - c) Treat the taxes borne indirectly by renters and those paid directly by homeowners equally.
 - d) Tax special purpose property (such as churches) only for the direct benefits received by the owners of such property.

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